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bastion of corporate
nservatism.

HE P&G REVOLUTION

ROBERT BERNER PAGE 52

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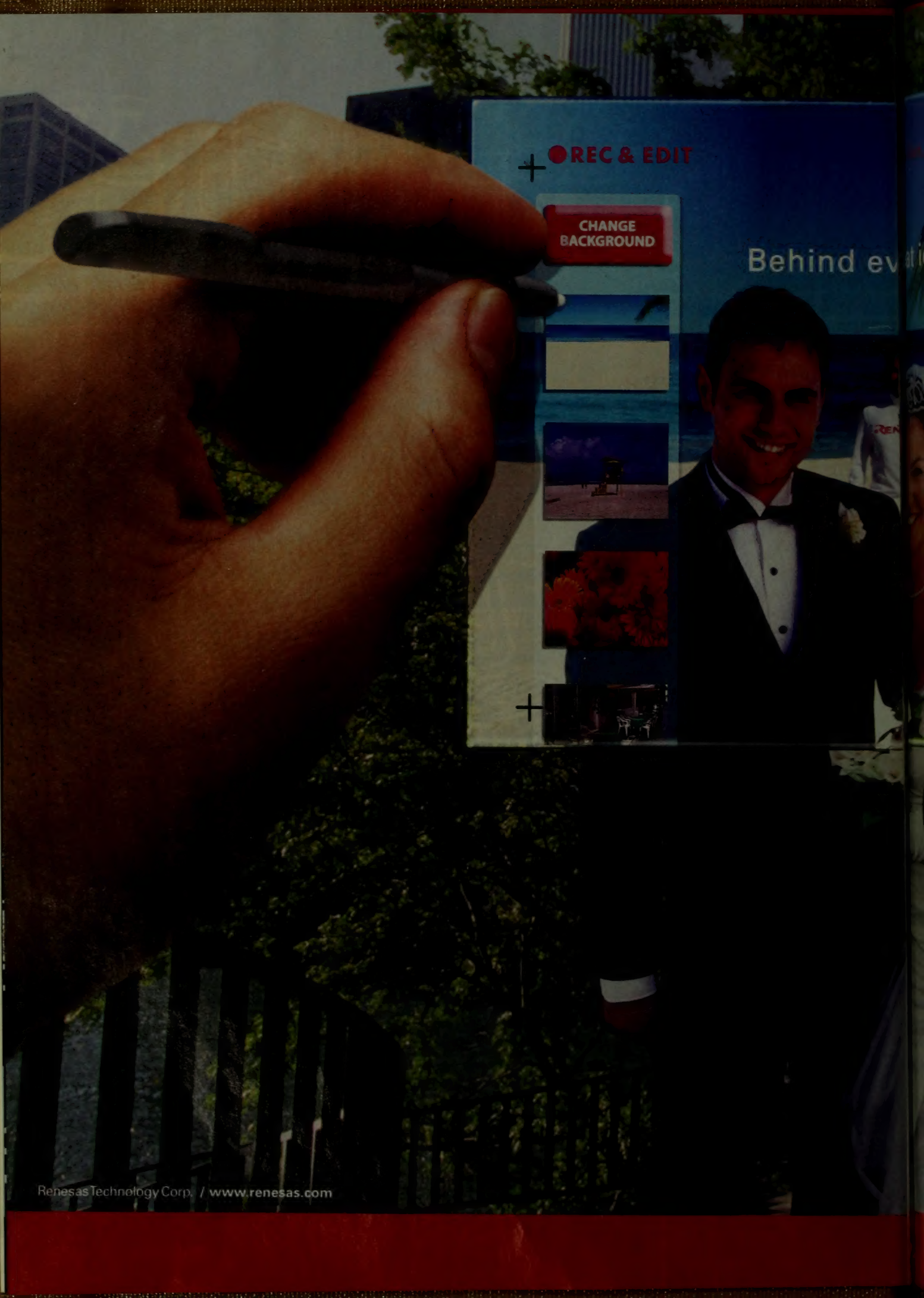

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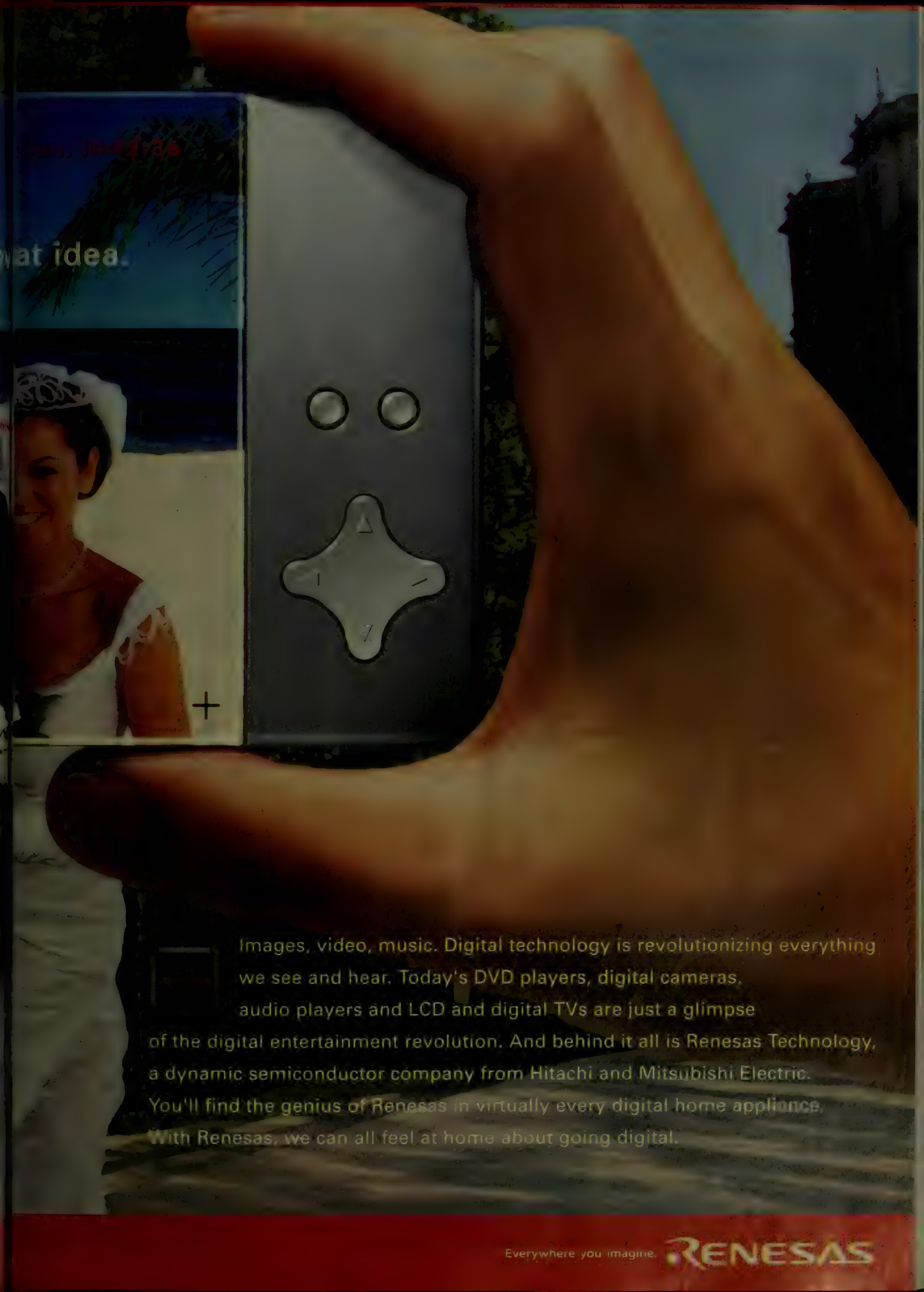

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COVER STORY

THE P&G REVOLUTION

Under CEO Lafley, the marketing powerhouse is again cleaning up page 52

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BusinessWeek

JULY 7, 2003

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A. G. Lafley, the quiet-spoken CEO of Procter & Gamble, is an unlikely revolutionary. But the 25-year company veteran is leading the most sweeping transformation of the consumer-goods behemoth since it was founded in 1837. The central tenet of Lafley's plan: that P&G should do only what it does best. Under Lafley, the notion that everything must be invented in-house is being challenged, and that's shaking up the corporate culture in Cincinnati

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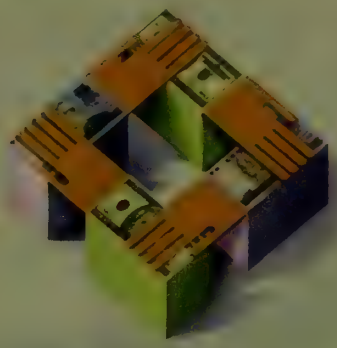

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Long Battle Ahead

Enron's fall also humbled energy outfit El Paso Corp., which must settle the final skirmishes in a shareholder revolt. Then comes the hard part: Rebuilding the business

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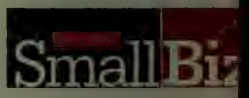

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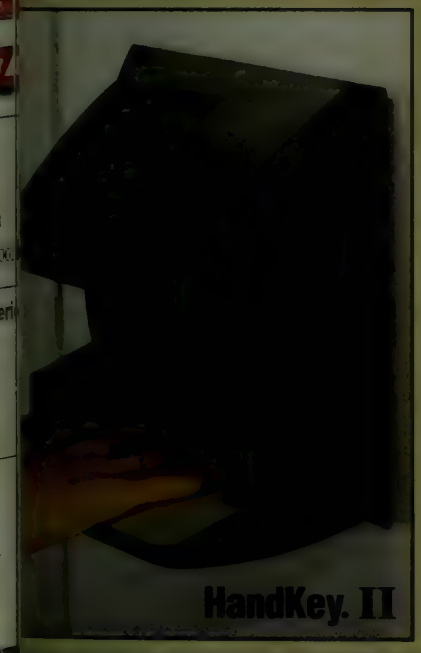

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Up Front

EDITED BY IRA SAGER

JOHNSON: *Another first for black biz?*

MINORITY REPORT

A BIG BET ON BANKING

ROBERT JOHNSON BUILT BLACK Entertainment Television, the first nationwide network for blacks. His purchase of the Charlotte Hornets—renamed the Bobcats—made him the NBA's first black majority owner. Now, he wants to establish the first national black-owned bank.

Since April, Johnson has been buying shares of Independence Federal Savings Bank in Washington, D.C., and now owns 3%. The bank has $246 million in assets and five branches, but its thrift status could let it expand with few regulatory hurdles. Johnson won't comment. His spokesperson, Naomi Travers, confirms that he is considering buying the bank. An Independence spokesperson says Johnson has not approached the bank.

The largest black-owned bank is OneUnited Bank, with $500 million in assets and branches in three states. Supporters say a nationwide bank is needed. "A lot of national banks pay lip service to minority lending," says Bernard Beal, CEO of black-owned investment bank M.R. Beal & Co. Johnson, with a net worth of $1.3 billion, could be out to change that. *Kevin Joy*

GAMING

WILL THE BORGATA ASSIMILATE YOU?

WILL ATLANTIC CITY EVER BE able to shake its image as a dropoff point for busloads of day-tripping grandmas?

Two Las Vegas operators, MGM Mirage and Boyd Gaming, are betting $1 billion they can transform the city into a destination resort like their hometown. Borrowing a page from the playbook of Vegas legend Steve Wynn, their new Borgata Hotel Casino & Spa resort, opening on July 3, will boast 2,002 rooms, 11 restaurants, plus the spa—all in a faux-Italian palazzo style.

Atlantic City slicker

The Borgata will be the first new Atlantic City resort in 13 years. Promoters hope it will rejuvenate the city the way Wynn's Mirage and Bellagio revived Las Vegas.

The Borgata's opening is coming none too soon: Competition from Indian casinos and slot machine-loaded racetracks have pushed Atlantic City's gaming revenues down 2% so far this year.

The Borgata is already making an impact. Harrah's, Showboat, and the Tropicana have pumped $600 million into new hotel towers and entertainment offerings. And the city is taking bids for a family-oriented entertainment complex. Maybe then Grandma will bring the grandkids and stay a while. *Christopher Palmeri*

TALK SHOW "I receive a lot of spam every day, much of it offering to help me get out of debt or get rich."

—Bill Gates, in an e-mail explaining how Microsoft plans to tackle spam.

AFTER 9/11

PROTECTING THE OTHER SILOS

THE FDA IS FINDING IT HARD to work with the food industry to close security gaps that could threaten America's cupboard. Before and after September 11, the agency produced three major studies about terrorist threats to the food supply.

The problem is, portions of the reports have been classified "secret." That data can't be shared with America's 2 million farms and thousands of importers, livestock feedlots, and food processors vulnerable to attack. "Some of the industry groups that most need to understand the dangers are out of the loop," says Robert Brackett, director of food safety at the FDA.

Among the dangers: terrorists launching an economic attack using, say, foot-a mouth disease, which kills imals but doesn't harm mans. Or poisoning proces food or food imports, wh could kill people.

One proposed solution i grant security clearance food-industry executives. with a big backup in secu

WEAPONS *of maize destruction?*

applications, that proc could take a year or m So the FDA is organizing visory groups that at l can be given unclassified s maries of the reports. Br ett hopes the summaries, curity clearances, declassifying material help. *Paul Magnus*

THE LIST **ANGELS IN THE BOARDROOM**

Even in this scandal-plagued era, some big companies are trying hard to do the right thing. Below, the highest-ranking companies in *Business Ethics*' annual corporate citizenship awards.

COMPANY	GOOD DEEDS
GENERAL MILLS	Joined with a nonprofit and a minority-owned food company to create 150 inner-city jobs
CUMMINS ENGINE	Funded construction of school and health clini near its Brazilian factory
INTEL	Worker injury rate is just 4% of industry avera
PROCTER & GAMBLE	One-third of managers are women, 16% are minorities
IBM	One of the first companies to implement child and elder-care programs
HEWLETT-PACKARD	Active volunteer committee of 300 employees seeks ways to make HP "greener"
AVON PRODUCTS	Consistently contributes money to breast cancer research, treatment, and prevention
GREEN MOUNTAIN COFFEE	Pays farmers higher prices by buying 25% of beans directly, cutting out middlemen

Data: *Business Ethics*, KLD Research & Analytics

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We couldn't imagine a more appropriate place to view the opening of Nissan's new plant than from inside our new Quest minivan. Quest will be the first vehicle to roll off the assembly line and represents the kind of innovative thinking that made the plant possible. The state of Mississippi and Nissan formed a partnership based on a common vision to build something remarkable. Mississippi delivered the construction, supplier coordination and infrastructure in record time. Now, the facility is ready to help power Nissan's revitalization by producing up to 400,000 vehicles. And Canton is enjoying the benefits of up to 5,000 new jobs. Which means our partnership has been truly successful – any way you look at it. To find out more, visit mississippiandnissan.com.

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Up Front

FINAL FANTASY: *It's a living*

$48,000 in an industry that's adding 5,000 jobs a year, according to Interactive Digital Software Assn., a trade group. Top game designers can make as much as $300,000 a year. The Dallas university expects some 40 students will fork over the $37,000 in tuition for the graduate program, which starts in the fall.

While the SMU Guildhall school of video games will teach everything from animation to software development, its biggest lesson will not be technical. It seems the stereotype is true: Designers tend to be nerdy young men with no social skills—and that's a shortcoming the school will address. "What we need are people who know how to work as a team," says Paul Jaquays, a director at Microsoft's game lab who helped design the course. "Right now a lot of people spend too much time flaming each other." Looks like SMU might crib from poli-sci and add a course in conflict resolution, too. *Charles Haddad*

CONTINUING ED

GRADUATING SUMMA CUM SIMS

SORRY, JAY LENO, BUT IT'S NO joke. Southern Methodist University is starting the nation's first school to train video-game designers. And contrary to your recent on-air quip, a video-gaming degree is not "more useless" than one in political science.

Grads of the 18-month program could start out earning

RETAIL DETAIL

A YEN FOR LUXURY—STILL

AFTER A DECADE OF ECONomic malaise, Japanese consumers' love affair with European luxury goods may be losing some of its spark. To rekindle the passion, luxury retailers such as Ferragamo, Louis Vuitton, and Coach are all opening big stores. On June 7, Japan's hip and trendy swarmed into Prada's new $85 million megastore in Tokyo. "Despite the recession, luxury brands still sell," says Seiko Yamazaki, associate research director at Tokyo's Dentsu Institute for Human Studies.

Problem is, the new shopping shrines are opening just as Japan's luxury goods market appears to be ebbing—

AT PRADA: *What malaise?*

with sales expected to drop 4% this year. Why the building binge? Retailers figure the new stores will help them get a bigger slice of a shrinking pie. It works: Louis Vuitton's sales jumped 15% last year, to $1.16 billion. Not bad for an economic downturn.

Sheridan Prasso in Tokyo

DRAWN & QUARTERED

GOVERNMENT SURPLUS

OREGON'S RED-LIGHT SPECIALS

THE STATE OF OREGON THINKS it can solve your gift-giving dilemmas. Just click on over to online auctioneer eBay and look for goods sold by Oregontrail2000.

There, you'll find item #3229347894 "For That Hard to Shop For Person." And what is the fabulous item? A framed 1998 health permit from the state of Nevada allowing the infamous Mustang Ranch brothel to operate its spa room.

Oregon has gotten so good at selling on eBay that government agencies outside the state use it to auction off their goods. The state, which takes up to a 10% cut, has sold farm animals, an airplane, and equipment from a g mine. Cindy Becker, direc of Oregon's online sales, s the state has raised about million this year.

Every product from Mustang Ranch, which clo in 1999, comes with its o certificate of authenticity.

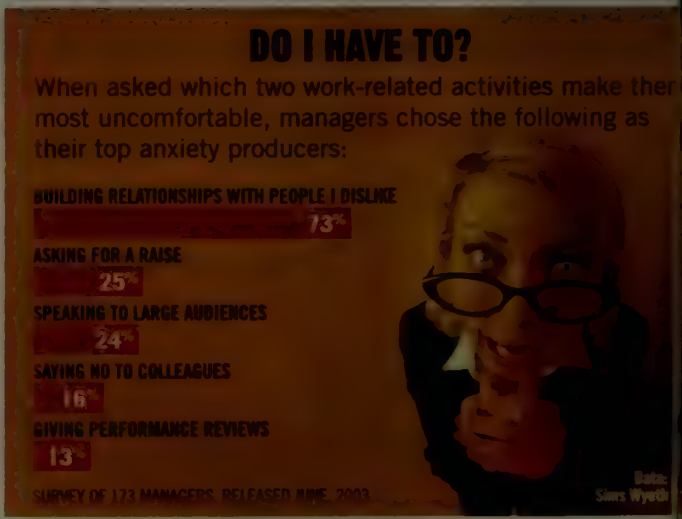
BORDELLO GOTHIC: *Going once*

state is taking bids thro June 27. But don't worr you miss out. Oregon pl to auction off two m batches of bordellobilia coming weeks. *Jay Gre*

THE BIG PICTURE

DO I HAVE TO?

When asked which two work-related activities make ther most uncomfortable, managers chose the following as their top anxiety producers:



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Readers Report

DON'T CRY FOR ME, AMAZON

Your article "Selling books like bacon" describes independent bookstores as "driven nearly to extinction" (Marketing, June 16). IPSOS BookTrends reports that independent bookstores have maintained a 15% market share for the past four years, a higher share than mass merchandisers or the Internet.

BusinessWeek mentions *The Lovely Bones*, a surprise blockbuster and one of many books that independent booksellers were first to recommend and promote. The surviving independent bookstores have strong community ties and loyal customers. A 15% market share is very significant in a very diverse retail environment.

Michael F. Hoynes
Marketing Officer
American Booksellers Assn.
Tarrytown, N.Y.

ONLY NOVICES ARE RUNNING FROM PRIVATE EQUITY

In "Private equity, public anger" (Finance, June 16), Mara Der Hovanesian asserts that investors in private-equity funds are "banging on the door to get out as hard as they once did to get in." On the contrary, most limited partners in private-equity, and specifically venture-capital funds, have the sophistication and financial savvy to realize that the asset class has a long-term horizon and outperforms the market over time.

Unrealized returns, whether they
positive or negative, are not meani
ful. One cannot measure the perfo
ance of a venture fund until the final
uidity event occurs, which typically ta
7 to 10 years.

Mark Hee
Presid
National Venture Capital A
Arlington,

LETTERS FOR READERS REPORT

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CORRECTIONS & CLARIFICATIONS

"Trustbusters zero in on Orbitz" (In Busines
This Week, June 23) stated that a June 1
Justice Dept. report on airline reservatio
systems criticizes "online ticketer Orbi
for what it deemed anticompetitive beha
ior." While the report does raise questio
about some industry practices and sa
that Justice has been closely examinir
Orbitz LLC, it does not criticize Orbitz for a
ticompetitive practices.

In "The Information Technology 100" (Cov
Story, June 23), the return on equity for Roge
Communications Inc. should have bee
69.3%, not 84.8%. This change, howeve
does not affect the company's ranking in t
return-on-equity category or the overall lis

"Drooling over Heinz?" (Inside Wall Stree
June 30) should have said that Bea
Stearns & Co. analyst Terry Bivens did n
lower his fiscal 2004 earnings estimate
$2.02 a share for H.J. Heinz & Co. Bivens r
tained his forecast of $2.15 a share. H.
Heinz spokesman Ted Smith also argues th
Heinz has strong earnings and sales ta
gets—8% to 10% for earnings and 3%
4% for sales—contrary to what analysts s

"Schering's Dr. Feelbetter?" (People, June 2
incorrectly stated 2002 revenues for the dr
Detrol. The correct figure is $757 million.

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THE CLINTON WARS
By Sidney Blumenthal
Farrar, Straus & Giroux • 822pp • $30

LIVING HISTORY
By Hillary Rodham Clinton
Simon & Schuster • 562pp • $28

TWO MIRRORS ON THE CLINTON YEARS

During Bill Clinton's two terms in the White House, his enemies kept the spotlight on his ethical shortcomings—alleged and real. At the time, First Lady Hillary Rodham Clinton blamed a "vast right-wing conspiracy." But now, it's Mrs. Clinton and one of the family's most spirited defenders who are keeping those hoary tales alive.

Two memoirs have hit the stands just weeks apart. Journalist-turned-Clinton-adviser Sidney Blumenthal's *The Clinton Wars* is a lengthy and often acrid reinterpretation of the cutthroat policy battles and scandal-mongering of the era. In *Living History*, Hillary Clinton eschews such details and presents an impressionistic portrait of an unlikely political life. Clinton relies largely on anecdotes to create a soft-focus picture: an idealistic suburban Chicago girl whose political journey began as a supporter of Republicans Richard M. Nixon and Barry Goldwater but who was transformed by the turbulent '60s and a charismatic Arkansan.

Both books are self-serving—but they serve different purposes. Blumenthal's obvious goal is to settle scores with Clinton's many detractors, including, in no particular order, Kenneth Starr, Newt Gingrich, Alfonse D'Amato, Rush Limbaugh, Matt Drudge, Paula Jones, Dick Morris, Henry Hyde, and a gaggle of investigative reporters who picked up on leaks by the Enemies of Bill. Reading *The Clinton Wars* is like watching professional wrestling: If you're a Clinton fan, you enjoy seeing the villains get their comeuppance. If you're a Clinton hater, you seethe at how an abject apologist for the bad guys uses questionable tactics to hurt your heroes. Either way, it's entertaining, even though Blumenthal is sometimes sloppy with his facts. (He incorrectly describes Gingrich as House Minority Leader, a position he never held, and says Ronald Reagan selected the first George Bush to be Vice-President in 1984, not 1980.)

Hillary Clinton—now a New York Senator widely believed to harbor Presidential ambitions—has a very different goal. Yes, she settles a few grievances and directs some partisan zingers at old foes. But while Blumenthal is looking back with anger, she is looking forward with studied equanimity. She's clearly aiming to reintroduce herself to the American public on her terms. Ever since she burst onto the public stage in 1991, amid the infamous "bimbo eruptions" of her husband's first Presidential campaign, Senator Clinton has been defined by the news media and her enemies. This memoir is her best opportunity to date to alter the images: Lady Macbeth, Joan of Arc, feminist extremist, ambitious carpetbagger, aggrieved wife who made a Faustian bargain.

To accomplish that, she chooses not to wallow in Whitewater nor mope about Monica. Instead, she skillfully creates a new political image of her own. And while *Living History* is never going to be mistaken for a literary masterpiece, it is surprisingly readable for a political memoir, a genre that is often stiflingly boring. Her prose, polished by a team of six credited helpers, is competent and sometimes chatty, though occasionally dense. It bogs down when the author turns to such policy issues as health care and welfare reform.

But Senator Clinton's book is mainly about herself, not her agenda. And someone who has been tight-lip about her private life, a personal m oir represents a challenge. The sen lifts the veil through a process of se tive candor.

Dozens of stories provide bits of sights into Hillary Clinton's comp psyche. And for many readers, they might succeed in melting away the age of the Ice Queen. You read ab her mother, a child of divorce who raised by a rigid Victorian grandmot You learn of the young Republican H ham who investigated voting fraud Chicago's South Side, trying to pr that Mayor Richard J. Daley stole 1960 election for Democrat John Kennedy. You see how a lecture by Reverend Martin Luther King opened her eyes to civil rights, and "a Viking from Arkansas" (her desc tion of the red-bearded Bill Clinto Yale Law School days) became the of her life. And you read, time again, how she was so angry at husband's cheating and lying that spent months contemplating a div from the President of the United St

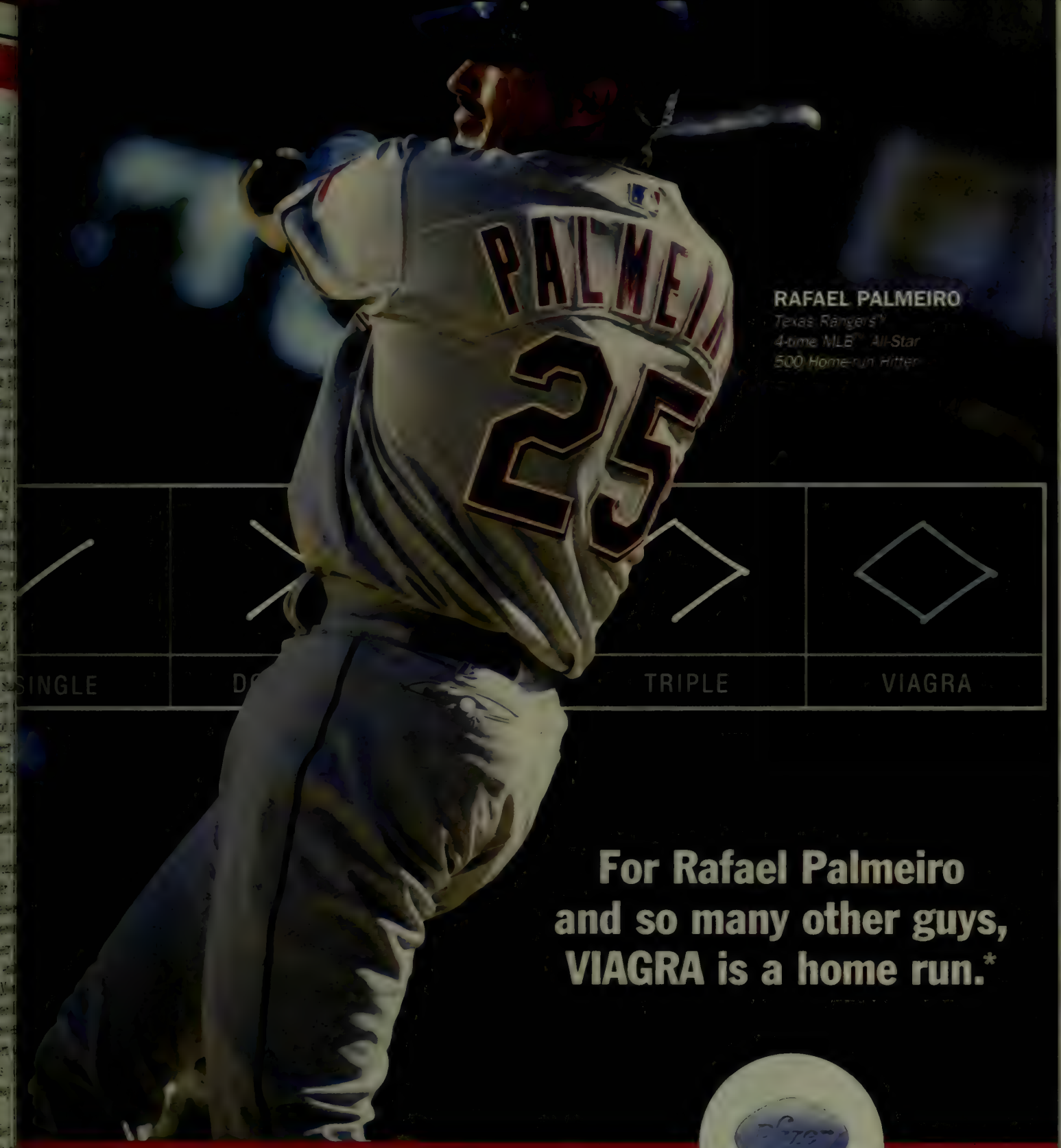
The result is a more human view well-known yet not well-understood lic figure. Beneath the tough veneer a sometimes brittle ego. Time and a her own mistakes and enemies' allegations send into funks. The ice melt bit at a time.

Senator Clinton's ca has its limits, however. shrouds daughter Chelse "a zone of privacy," reco ing precious few of their cussions and omitting en ly their talk of Mo Lewinsky. And her reco tion of how she discov her husband's affair with the intern tradicts earlier media accounts. says he told her; press reports say learned earlier from a lawyer.)

Living History has confounded skeptics by becoming an instant b seller. If the book's popularity is example, Hillary Rodham Clinton c be a potent, if divisive, Presidential didate. The media, and the vast r wing conspiracy, would do well n underestimate her. Again.

BY RICHARD S. DUN
Dunham covers the White H

WHILE BLUMENTHAL LOOKS BACK WITH ANGER, HILLARY LOOKS AHEAD WITH STUDIED EQUANIMIT



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se see patient summary of information for* VIAGRA *(25-mg, 50-mg, 100-mg) tablets on the following page.

GRA is indicated for the treatment of erectile dysfunction. Remember that no medicine is for everyone. If you use nitrate drugs, often used to control chest , also known as angina), don't take VIAGRA. This combination could cause your blood pressure to drop to an unsafe or life-threatening level. Discuss your era, health status with your doctor to ensure that you are healthy enough to engage in sexual activity. If you experience chest pain, nausea, or any other omforts during sex or an erection that lasts longer than 4 hours, seek immediate medical help. The most common side effects of VIAGRA are headache, a flushing, and upset stomach. Less commonly, bluish vision, blurred vision, or sensitivity to light may briefly occur.

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PATIENT SUMMARY OF INFORMATION ABOUT

VIAGRA®

(sildenafil citrate) tablets

This summary contains important information about VIAGRA®. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA.

This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

What Is VIAGRA?

VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

How Sex Affects the Body

When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

How VIAGRA Works

VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

VIAGRA Is Not for Everyone

As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates–either regularly or as needed–you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

What VIAGRA Does Not Do

- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV–the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

What To Tell Your Doctor Before You Begin VIAGRA

Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause a small temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- have ever had a stroke
- have low or high blood pressure
- have a rare inherited eye disease called retinitis pigmentosa
- have ever had any kidney problems
- have ever had any liver problems
- have ever had any blood problems, including sickle cell anemia or leukemia
- are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

VIAGRA and Other Medicines

Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies.

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking alpha-blocker therapy for the treatment of high blood pressure or prostate problems, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as you take your dose of alpha-blocker.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You.*)
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

Finding the Right Dose for You

VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period. If you are taking alpha-blocker therapy, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as your dose of alpha-blocker.

How To Take VIAGRA

Take VIAGRA about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

Possible Side Effects

Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

Accidental Overdose

In case of accidental overdose, call your doctor right away.

Storing VIAGRA

Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

For More Information on VIAGRA

VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

23-5515-00-6 Rev. 6 Sept. 2002

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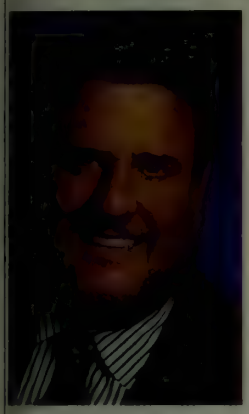

hallenge-esponse ltering ystems are kely to wipe ut e-mails ou want, too

Overwhelmed e-mail users are so disgusted by the volume and the nature of junk flowing into their in-boxes that they are ready to try just about anything that promises to ease the problem. As is often the case with desperation measures, there's a danger that some of the steps being taken will end up making matters worse.

The development that causes concern right now is the rapid growth of what are known as challenge-response systems. This approach, which bills itself as the only method capable of blocking 100% of spam, tries to verify that a message was sent by a human being—rather than via a mass-mailing program—before accepting the e-mail. It does this by requiring that senders personally confirm that they are actual people before their messages are accepted. Mailblocks promises to eliminate spam in its $9.95 a year Web-based mail service. MailFrontier Matador, a $29.95 add-on to Microsoft Outlook or Outlook Express, offers it as an option along with more conventional spam filtering. And in the biggest boost yet to challenge-response, EarthLink has made it available without additional charge to its 5 million or so subscribers.

Here's how it works: When you receive an e-mail, the program checks the sender against a list of acceptable names (your address book is generally used as a starting point for compiling the list.) If the name is not found, a message asking the sender to solve a simple problem is sent back. The goal is to pose a challenge that is very easy for a human being but difficult or impossible for a computer. Typical challenges ask how many kittens are in a picture, or to read a number that is displayed in an odd, distorted typeface against a complex background. If a correct response is received, the mail program puts the message in your in-box. Otherwise, it throws it away or puts it in a special "suspect mail" folder. The concept is that Aunt Minnie will quickly respond with the correct solution and her mail will go through, while the mailbots trying to sell you drugs, larger appendages, and cheap mortgages will be stumped.

Challenge-response definitely stops spam. The problem is that it has unintended consequences. These can be serious, because most of us depend more on machine-generated mail than we realize. Consider this typical e-commerce scenario. You buy a plane ticket on ual.com, and United Air Lines sends you a confirmation and itinerary. Since confirmation@uasupport.com isn't in your approved list, your system sends back a challenge to which United cannot respond. Your confirmation gets buried among the spam. The same fate will befall all messages generated by mailing lists unless you have manually entered the address in your approved list. I regard certain lists as valuable sources of information, and I even like getting promotional mailings from companies I choose to do business with. Even conventional antispam filters pose problems for such lists, but with challenge-response, you are sure to toss out the baby with the bathwater unless you carefully scan all rejected messages and add those you want to your approved list.

Challenge-response has other problems as well. Some systems, including EarthLink's, require you to click on a link to a Web page to answer the challenge. If you are working on a device that can't access the Web or display graphics—a BlackBerry, for example—you cannot respond. In addition, an often overlooked consideration is the impact of the challenges, which generally involve graphics, on the visually impaired. EarthLink suggests that a visually impaired sender telephone and ask to be added to the recipient's permitted list. But that seems to put the burden in the wrong place. For federal agencies required to provide equal access by the Rehabilitation Act, and for the corporations voluntarily complying with those rules, visual challenges won't do.

Spam has become a serious threat to the usefulness of e-mail. So it's no surprise that spam-fighting products are hitting the market much faster than I can hope to evaluate them. Most use conventional filtering and work more or less well. Challenge-response systems are a special problem, though, and I fear that their widespread adoption could be almost as great a threat to e-mail as spam itself. ■

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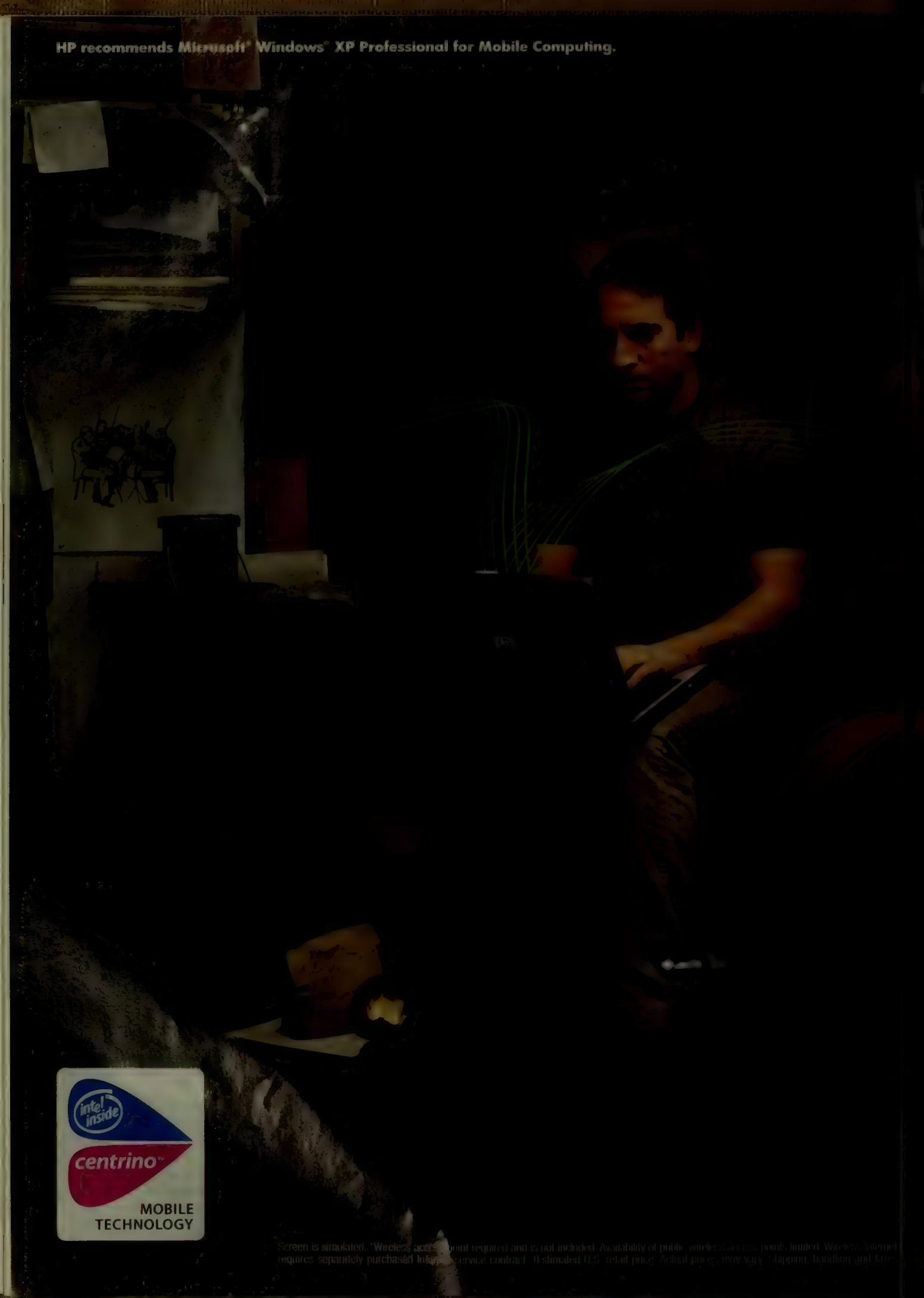

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BY LAURA D'ANDREA TYSON

NEEDED: AFFIRMATIVE ACTION FOR THE POOR

UNEQUAL: Admission to U. S. colleges is skewed heavily toward rich kids. To break the cycle, poor applicants deserve special consideration

Laura D'Andrea Tyson is dean of London Business School.

In the Information Age, higher education is more and more important as the ticket to economic success. Unfortunately, access to this ticket depends on economic success itself. A young person's chance of getting a college or post-graduate education depends on family income. Children from low-income households are much less likely to graduate from college than children raised in high-income households. As family incomes become more unequal, there are signs that the relationship between income and college graduation is becoming stronger.

Children born into high-income households become part of a virtuous circle of success. Parents with university degrees tend to earn more, set higher educational goals for their children, and invest more time in the children's schooling than parents who have a high-school education or less. In addition, given local financing of K-12 public education and the segregation of most local communities by income, the children of high-income parents tend to attend better schools and receive better preparation for college.

A study on socioeconomic status and selective-college admissions by the Century Foundation provides stark evidence of the links between family background and higher education. The recent Supreme Court ruling that it was legal to give some preferential treatment to disadvantaged minorities speaks to this point.

Low-income students who graduate from high school with at least minimal qualifications for four-year institutions enroll at half the rate of their high-income peers. Only 78% of students from low-income families who rank as top achievers on tests of college readiness actually attend college. In contrast, nearly the same share of students from high-income families who rank at the bottom of such tests do so. The conventional view is that students from low-income families don't enroll or complete college because they are not academically qualified. But the New Century evidence paints a different and more hopeful picture. Despite the considerable obstacles they encounter as they grow up, many high school students from low-income, disadvantaged households are qualified but are choosing not to attend college or to attend colleges that are less selective than their qualifications justify.

What can be done to help such students get the ticket to college? Clearly, more generous financial aid is part of the answer. The financial barriers to college enrollment among students from low-income families are great—and growing. Since the early 1970s, the value of federal packages for low-income students has fallen p cipitously as a percentage of college costs. the same period, college costs as a portion family income have remained unchanged for t top 40% of the family income distribution wh increasing substantially for low-income famili Without a big increase in federal and state s port for means-tested student aid programs growing number of qualified students from lo income households will find the door to high education and upward mobility closed for th and their children.

The nation's colleges and universities sho also do more to help children from low-inco families. They should mount more aggressive forts to identify and recruit students from low come families with strong academic potent early in their high-school careers, providing th with better information about the course quirements and procedures for college adm sion. Colleges should also expand their financ aid programs for low-income students. Curren more four-year colleges offer financial aid to a letes and students with "special nonacaden talents" than to disadvantaged students. Fina more colleges should follow the lead of the U versities of California, Florida, and Washingt and design admissions programs that evalu the academic accomplishments of applicants light of such obstacles as family income, paren education, and social environment. Doesn't SAT total score of 1200 combined with an A erage mean something different for an applic raised in a low-income household and educated a run-down public school than for an applic from a high-income home and educated in outstanding private school?

According to a recent survey, two-thirds Americans support preferences in college missions for equally qualified low-income s dents over high-income students. Century Fo dation research demonstrates that su economic affirmative action policies would d matically increase the share of students fr the poorest half of the population in the to number of students admitted to the natio top 146 colleges. Today, that share is just 1 lower than it would be if admissions decisi were based on grades and test scores alo Even the most selective colleges have pref ential admissions programs for the offspring their mostly affluent alumni. Surely there scope for preferential admissions for qualif students who are poor.

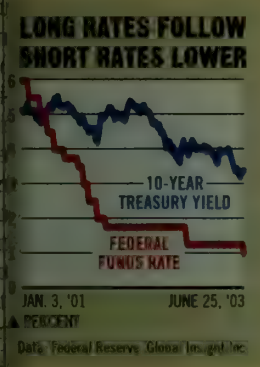
BY JAMES C. COOPER & KATHLEEN MADIGAN

A SHORT CUT TO LOWER LONG-TERM RATES

With housing booming, the Fed's move is aimed at giving business a boost

U.S. ECONOMY

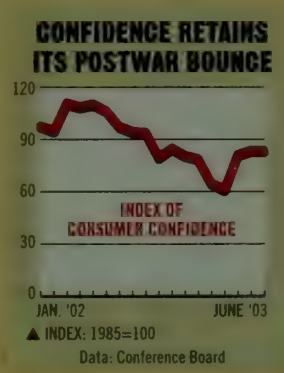
On the first day of the Federal Reserve's June 24-25 meeting, policymakers sat down to discuss the economic outlook in preparation for their semiannual report on monetary policy and economic forecast, due in mid-July. Almost certainly, the policymakers' projections were bolstered by gains in the financial markets this spring and improvement in the economic data. Then, on the second day of meeting, the policy committee seemed to ignore those better prospects and cut its overnight lending rate by a quarter-point, to 1%.



Why did the Fed cut rates? Normally, an improving outlook would cause the central bank to hold its fire, especially after it had already slashed its policy rate from 6.5% to 1.25% over the past 2½ years, and in the face of some powerful fiscal stimulus when the tax cuts begin to kick in on July 1.

But these are hardly normal times. With inflation exceptionally low and recovery still not assured, the risk of overstimulating the economy is minimal. But the Fed has taken short-term interest rates about as low as they can go. Now, policymakers appear to be concentrating on a new tactic—getting long-term interest rates down and keeping them there until the anemic recovery begins to show a little energy. The hope is that lower rates across the yield spectrum will provide a healthy dose of iron.

BEAR IN MIND, the bond market is the key to more accommodative financial conditions. The lift from low long rates is already evident in the ongoing housing boom. Not only have cheaper borrowing costs boosted home sales and new construction, but they have enabled millions of homeowners to refinance their mortgages. Now, low bond yields must work their magic on the business sector. They will make stocks relatively more attractive, and low rates across the board make U.S. debt securities less appealing to foreigners. That keeps the dollar down, boosting international competitiveness for exports and lifting earnings from foreign operations. The crucial link between better financial conditions and a solid recovery will be a pickup in capital spending, which is heavily dependent on both growth in demand and financing costs.



Before late June, the Fed had managed the goal of lower long rates through words instead of overt policy actions, such as buying long-maturity Treasury bonds. The Fed's intent first became clear after its last meeting, on May 6, when policymakers warned of an "unwelcome substantial fall in inflation." Since then, simply talking publicly about the risks of deflation—however small they may be—crushed inflation expectations, a key component in long-term rates. The discussion convinced bond traders that the Fed would hold short-term rates down for many months to come.

But in recent weeks, bond investors have grown a little weary of the Fed's jawboning. In the week leading up to the latest meeting, long-term rates inched up, as economic data started to look firmer. Basically, the bond market was telling the Fed, "Talk is cheap. Put up or shut up." So on June 25, the Fed had to put its money where its mouth was. The alternative was to risk a sharp reversal in bond yields that could thwart the economy's chances to stage a strong recovery.

THE FED GAVE THE BOND MARKET most of what it was looking for. A survey by Bloomberg Financial Markets showed that one out of three Fed watchers expected a half-point cut. In fact, one policymaker, San Francisco Fed President Robert T. Parry, dissented from the rate decision, preferring a half-point cut. However, the Fed's improved outlook for growth apparently undermined the rationale for a larger cut.

Even so, the Fed's policy statement held out the hope of further policy easing. As it did in May, the Fed separated its outlook for economic growth from that for inflation. For growth, it said, "recent signs point to a firming in spending, markedly improved financial conditions, and labor and product markets that are stabilizing." Recently, Fed officials have seen improving trends in the leading indicators, retail sales, regional factory surveys, and consumer confidence (chart).

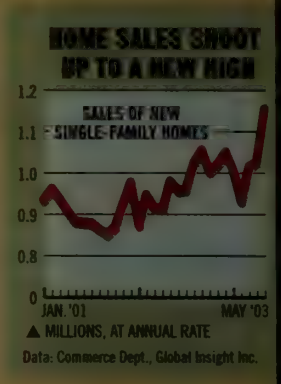
But the Fed repeated its May concern about the risk of deflation, and said that this concern is "likely to

predominate for the foreseeable future." In effect, the Fed was hinting to the bond market that it was leaving the door open for further easing in case the risk of deflation rises. Indeed, after the cut, trading in federal-funds futures pointed to a growing belief that the Fed will cut rates again at its August meeting. But if the Fed's campaign to talk long rates lower produces stronger growth and pricing power, the June cut will be the last for this cycle.

SO FAR, THE FED'S SUCCESS on the long-rate front can be seen mostly in housing, where demand remains strong. New home sales in May jumped 12.5%, to a record 1.16-million annual rate (chart), while sales of existing homes edged up 1.2%, to a 5.9-million pace. In addition, lower rates over the past few months have generated a new burst of mortgage refinancings. When these new loans are closed over the next few weeks, consumers will reap the benefits of either taking cash out of their homes, lowering their payments, or shortening the maturity of their loans.

However, the strong influence of long rates on all facets of housing raises the question: Will a turnaround in the bond market cause the sector to collapse? The Fed doesn't seem ready to confront that risk just yet, but at some point it will have to. Eventually, long rates will rise, as they always do, as a result of a better outlook for the economy. Stronger growth will generate new jobs and fatter pay rais and those benefits to the consumer sector will o weigh some of the drag from rising mortgage rate

Even so, expect the higher borrowing costs to slow home sales and temper price gains somewhat. That's because buyers typically determine housing affordability by their monthly mortgage payments rather than the overall price of a house. Less demand will slow construction, or at least cause a shift to building cheaper homes, which will hold down housing's contribution to real gross domes product growth. But this slowdown will occur just other sectors in the economy, bolstered by the comi stimulus from tax cuts, begin to add to growth. As result, a softer housing sector won't be a big drag the economy.



But the real measure of the Fed's success at keepi long rates down will show up in a rebound in the bu ness sector, where weakness in capital spending h been the chief factor holding back the recovery. T Fed knows that once business investment picks u the economy will kick into a higher gear, and the risk deflation will become a moot point.

BRAZIL

THE HEAT IS ON LULA TO SPUR GROWTH

Brazilians are beginning to wonder when they will benefit from the economic growth promised by President Luiz Inácio Lula da Silva during last year's election campaign. Six months after Lula took office, economists say Brazil will grow less than 2% this year for the third year in a row.

Rising impatience over tepid growth may have played a role in the central bank's half-point cut in interest rates on June 18, to 26%. It was the first cut in almost a year, even though yearly inflation, running at a seven-year high of 17.2% in May, is double the central bank's 8.5% target for 2003. The move came after sustained political pressure from, among others, Lula's Vice-President, businessman José Alencar. The powerful São Paulo federation of industries threatened job cuts if rates didn't fall.

At stake is the credibility of the central bank, which up to now has shown caution in its battle against inflation. Prices soared last year after the currency's sharp depreciation, partly reflecting concerns over how the leftist Lula would manage the economy. Although inflation has slowed in recent months, the 8.5% target will be difficult. Prices for energy and telephone service are due to rise in June and July.

Meanwhile, the economy is stuck in the mire. April industrial production plunged 4.2% from a year ago, the weakest showing since the 2001 energy crisis. The latest rate cut will do little to help consumers and businesses, some of whom must borrow at an nual rates of 100% or more, and real interest rates—the market rate minus inflation—remain high

Without further rate cuts, oppo sition to Lula's government will grow. Recent weeks have seen discontent and demonstrations by public sector workers, unhappy with proposed cuts to pension benefits. So far, Lula's approval rating remains at about 70%. He has shown commitment to reform needed to boost the economy and investor confidence. Maintaining a credible monetary policy will be crucial to achieving those goals.

By Jonathan Wheatle in São Paul

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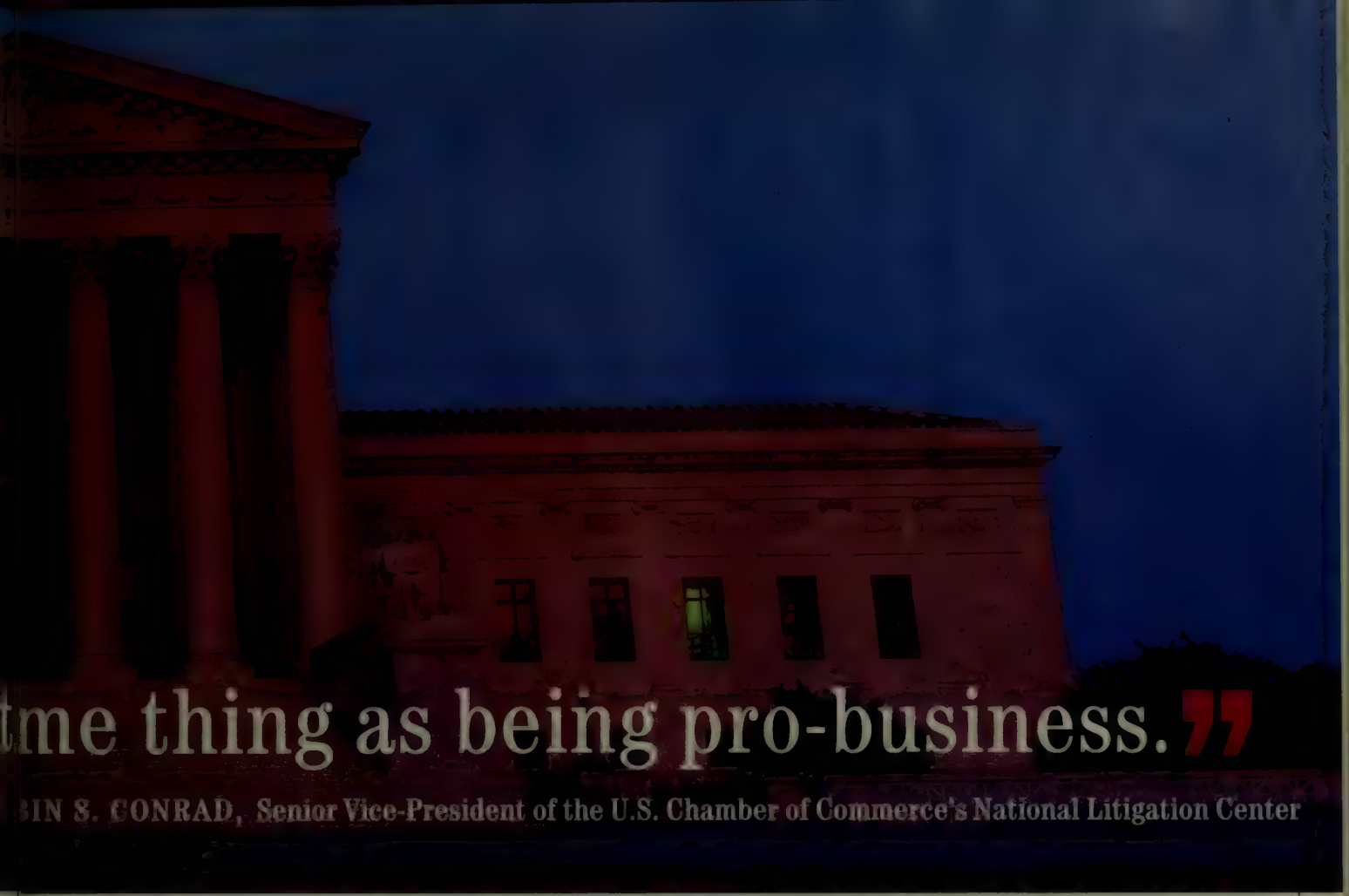
HIGH COURT ANXIETY

Why business is fretting about the appointments to come

Business cheered when the U.S. Supreme Court blessed affirmative action in the landmark *Grutter v. Bollinger* decision on June 23. Citing legal briefs signed by more than 30 companies, including General Motors, Microsoft, KPMG International, Bank One, Eli Lilly, and Procter & Gamble, Justice Sandra Day O'Connor based her ruling, in part, on the value of ethnic diversity in the workplace. "American businesses have made clear that the skills needed in today's increasingly global marketplace can only be developed through exposure to widely diverse people, cultures, ideas, and viewpoints," she wrote on behalf of a narrow 5-4 majority.

But Corporate America's celebration could be short-lived. Three justices—78-year-old Chief Justice William H. Rehnquist, 73-year-old O'Connor, and 83-year-old John Paul Stevens—are going to be stepping down one day soon, perhaps very soon. While Rehnquist's retirement would be unlikely to change the balance of the Court, both O'Connor and Stevens voted in favor of the University of Michigan Law School's affirmative action plan. If President George W. Bush replaces either of them with an ideological conservative along the lines of Antonin Scalia or Clarence Thomas, both of whom he has long held up as his favorite Supreme Court justices, the next case considering the use of racial preferences by schools, police academies, or department stores could easily go the other way.

Nor is affirmative action the only issue that could swing against the business community if Bush gets a chance to reshape the high court. Corpor



tme thing as being pro-business."

BIN S. CONRAD, Senior Vice-President of the U.S. Chamber of Commerce's National Litigation Center

orneys have long considered Scalia, homas, and their ilk a mixed bag. ue, they protect companies from med- esome federal regulations, but they nd to ignore equally onerous state ws. They stand up for corporate prop- ty rights but vote against tort re- m. "Being a conservative is not the me thing as being pro-business," says bin S. Conrad, senior e-president of the U.S. amber of Commerce's Na- nal Litigation Center.

Conservatives come in ny species. The Constitu- nal conservatism of Scalia d Thomas has nothing to with the economic con- rvatism of the Republican rty. It is based on a set of nvictions about how laws ould be interpreted, rather an any broad ideological mmitment to free mar- ts. In essence, the two ju- ts that Bush admires so ch are legal fundamental- s. They believe that the nstitution is like the Holy ble—a sacred document at should be interpreted rrowly and literally. What I look for in the Con- tution is precisely what I k for in a statute: the ginal meaning of the text," wrote Scalia in his 1997 book, *A Matter of Interpretation.* He calls himself a legal "originalist."

This ideology has already driven Scalia and his intellectual soulmate to vote against Corporate America in a couple of key cases in the current term. So far, the biggest victory for business has been *State Farm Mutual Automobile Insurance Co. v. Campbell*, in which a six-judge majority held that the due-process clause of the 14th Amendment limits gargantuan punitive-damage awards. Among the three dissenters were Scalia and Thomas, whose strict view of the Constitution led them to conclude that the document could not be used to cap runaway jury awards. The duo were in the majority, however, in *Norfolk & Western Railway v. Ayers*—Corporate America's biggest loss. In a 5-to-4 vote, the court turned down an opportunity to limit the liability of asbestos defendants. The justices declared that the tidal wave of litigation in this area didn't justify modifying the traditional common-law tort rules, even though those rules have driven dozens of companies into bankruptcy.

This is the most clearly divided Supreme Court in history. Recent casebooks are full of rulings that might have been decided differently if a Scalia clone sat in place of O'Connor or Stevens. Witness *BMW of North America Inc. v. Ira Gore Jr.*, a 1995 decision that many people consider

A SUPREME COURT VACANCY: HOW BUSINESS WOULD FARE

If an opening occurs, President Bush may appoint a judicial conservative like Justice Scalia or Thomas. That could tilt the court on some key business issues:

ANTI-BUSINESS	PRO-BUSINESS
▶ TORT REFORM Scalia and Thomas have consistently voted against efforts to restrain punitive damages—a top business priority. The duo believe the Constitution imposes no limits on jury awards.	**▶ EMPLOYMENT LAW** One of the most costly federal regulations is the Americans with Disabilities Act. Scalia and Thomas have been reluctant to expand corporate obligations under the ADA.
▶ STATE REGULATION Judicial conservatives defend federalism. They're generally unwilling to preempt state laws that place higher standards on companies than overlapping federal statutes.	**▶ PROPERTY RIGHTS** Conservatives cherish property rights. Both Scalia and Thomas are skeptical of environmental and zoning regulations that limit companies' ability to profit from their own property.

the most important business victory of the past decade. Like the State Farm case, it dealt with whether the Constitution places a ceiling on punitive damages. Five justices—including Stevens, O'Connor, David H. Souter, Anthony M. Kennedy, and Stephen G. Breyer—held that it did. If Scalia and Thomas had one more vote in their dissenting camp, the BMW decision would have gone the other way.

Besides tort reform, the other issue that could swing against Corporate America if the fundamentalist camp grows is federal preemption. This is the doctrine that companies use when they want to protect themselves against a tough state law. For example, after Beneficial National Bank, a division of HSBC Holdings PLC, was sued for violating Alabama's laws against usury, the bank responded by asserting that it was in compliance with the National Bank Act—the federal law it claimed was the sole authority on consumer interest rates. In a decision released on June 2, seven judges agreed. The two dissenters? Scalia and Thomas. The majority's holding "represents a sharp break from our long tradition of respect for the autonomy and authority of state courts," Scalia complained.

This isn't to say that originalist judges are always bad news for companies. Far from it. There are plenty of issues where their thinking is more in tune with the business community than the court's liberal wing. Scalia, Thomas, and others in their mold are passionately devoted to the values that the Founding Fathers cherished, such as property rights. They tend to support developers fighting local zoning regul tions and companies trying to argu that environmental laws constitute "ta ings" of their private property.

Although the court takes few inte lectual-property cases, their instinc would probably be to support mus companies over digital pirates. Similar Scalia and Thomas are strong prop nents of free speech for companies the doctrine that protects e-mail spa justifies unlimited corporate political d nations, and is used by drug compani and tobacco manufacturers to comb Food & Drug Administration advert ing restrictions. A major corporate fre speech decision is expected to be han ed down on June 26 in *Nike Inc. Kasky*, which will review whether c Philip H. Knight can be sued for maki allegedly false statements about t

COMMENTARY

By Mike France and William C. Symonds

DIVERSITY IS ABOUT TO GET MORE ELUSIVE, NOT LESS

Smart companies have seen the future—and it isn't lily-white. The Census Bureau predicts that between 2000 and 2020, the number of Hispanics, African Americans, Asians, and Native Americans in the U.S. will grow by 42 million. In contrast, Caucasians will rise by a mere 10 million.

The message in this data is clear: The majority of Corporate America's new customers and workers are going to be minorities. That's why the business community vigorously defended the University of Michigan's affirmative-action programs in 2003. "It's a business need, not a legal need," says Jay A. Redman, vice-president for service, selling, and training at Saks Fifth Avenue. Saks boosted minority recruitment and held racial-sensitivity training sessions in 2001, he says,

SCHOOL OF HARD KNOCKS

Economics counts more than admission policies in determ who goes to college—and gra

after focus groups said "our bran not welcoming" to nonwhites.

Like many executives, Redma relief when the U.S. Supreme C upheld the fundamental legality University of Michigan Law Sch firmative-action program in *Gru Bollinger*. But while companies ue diversity have won a big bat may still lose the broader war. Grutter ruling does nothing to r long-term economic trends that many low-income minority stude of college. And the high court's ion decision in *Gratz v. Bollinge* overturned a points-based unde ate affirmative-action program, to make it much harder for som state schools to get large numb blacks and Hispanics on campus porate America will have a mor cult time getting the workforce needs," warns Thomas G. Morte director of Postsecondary Educ Opportunity in Oskaloosa, Iowa

Despite the attention given t Supreme Court decision, the re that economics plays a more im role than admission policies in d mining who goes to college and graduates. Fewer than 3% of th tion's minority college students the 150 or so selective four-yea leges that were most affected b Court's rulings, says Anthony P Carnevale, a vice-president at

mpany's Third World em-oyment practices."

In the near term, a re-mped Supreme Court uld probably help Corpo-te America most with the mericans with Disabilities t—a statute that has been e focus of several recent se decisions. Since it was acted in 1990, the ADA has en implemented with thou-nds of pages of detailed ar-itectural-design regulations. The is-e is whether these requirements are unconstitutional expansion of the law. believe that requiring a 36-inch door-y is an appropriate way of ensuring ual protection [for disabled people]," ys Linda D. Kilb, a staff attorney th the Disability Rights Education & efense Fund Inc. But that is a view t textualists like Scalia & Co. might d harder to uphold, Kilb concedes, given that "nowhere in the 14th Amendment does it say that equal protection is a 36-inch doorway."

IN THE BALANCE A replacement for O'Connor (left) or Stevens could bring a new direction on affirmative action—and lots of other issues

Of course, the ADA controversy is part of a much broader social debate about the scope of civil rights. The clamor surrounding these issues—not to mention the continuing abortion controversy—has drowned out the narrow legal technicalities of interest to business. So far, most companies have steered clear of the acrimony associated with federal lower court judicial appointments—and they're likely to do the same thing if any Supreme Court vacancies open up. "Our customers are Democrats, Republicans, and independents," says a high-ranking attorney at one of the country's biggest consumer-product companies. "There's too much blowback potential."

Don't mistake Corporate America's quiet for indifference, though. The stakes in the judicial wars are enormous for many industries. The historical record indicates that they would probably be better off if the MBA President appoints a pragmatic conservative in the mold of Kennedy rather than an ideological conservative like Scalia or Thomas.

By Mike France in New York

esting Service. Most minority s attend community colleges and state schools, whose budgets g hit as the states deal with st fiscal crisis they've faced orld War II. That's forcing state to cut classes. Many have p tuition 10% or more for this er a 9%-plus hike last year. e same time, financial aid for diest students isn't keeping e Pell Grant, the core federal for poor students, covered 84% ost of attending a four-year pub-ersity a generation ago. In the c year now ending, the grant just 42%. While the cash affects whites and nonwhites e impact is greater in minority ities, which are more likely to ncome. Tuition hikes "at the vel will affect the lives of a lot llege students ir families e Supreme decision," atrick M. president of tional Center lic Policy & Education. court's ruling igan's under-e admissions also threat-rimp the mi-talent pipeline porations de-. The justices ools must laborious, case analysis of each applicant, in which race is a "plus" factor rather than a decisive determinant. This will force big state schools, such as Michigan, Ohio State, and Penn State, to hire more admissions officers if they want to continue to aim for diversity.

There's little doubt that many of these institutions remain committed to affirmative action, but the impact will vary enormously among the states. Michigan, for one, insists it will spend whatever it takes to comply. But in California, a voter-approved ban on affirmative-action admissions will block state schools from taking race into account. The cost of compliance, combined with political opposition to affirmative action in states such as Florida and Georgia, will limit the extent to which other schools pursue diversity.

That's why businesses plan to lean hard on schools to maintain diversity. For its part, Kellogg Co. says it will limit its support of campuses that don't continue to enroll and graduate growing numbers of ethnic minorities. As part of that effort, CEO Carlos M. Gutierrez says Kellogg won't let execs speak at student functions, attend recruiting programs, or offer scholarship money to schools that skimp on affirmative action. "We'll continue to apply pressure on schools and universities to have an active diversity program," he says.

Threats probably won't be enough. Companies already spend plenty on minority outreach via internships, scholarships, ad campaigns, and recruiting staffs. Chicago-based Bank One Corp., for example, helped raise $1.2 million at a recent dinner benefiting the United Negro College Fund Inc. And the lender is helping predominantly black Chicago State University raise as much as $1 million a year for a program that pairs students with business mentors. Faced with a diminishing flow of nonwhite applicants, though, corporations may have little choice but to do a lot more—or put their very futures at risk.

With Aaron Bernstein in Washington, D.C., Roger O. Crockett in Chicago, and Jennifer Merritt in New York

MAINTAINING A MULTICULTURAL WORKFORCE: NECESSARY, BUT DIFFICULT

MOST NEW CUSTOMERS WILL BE MINORITIES...

INCREASE IN U.S. POPULATION* BETWEEN 2000 AND 2020, BY RACIAL GROUP

HISPANICS	23 MILLION
BLACKS	10
WHITES	10
OTHER**	9

*INCLUDING IMMIGRANTS
**ASIANS, NATIVE AMERICANS, ETC.

...AS WILL MOST WORKERS...

INCREASE IN LABOR FORCE BETWEEN 2000 AND 2010, BY RACIAL GROUP

HISPANICS	6.8 MIL.
BLACKS	2.8
WHITES	2.6
OTHER*	1.2
IMMIGRANTS**	6.1

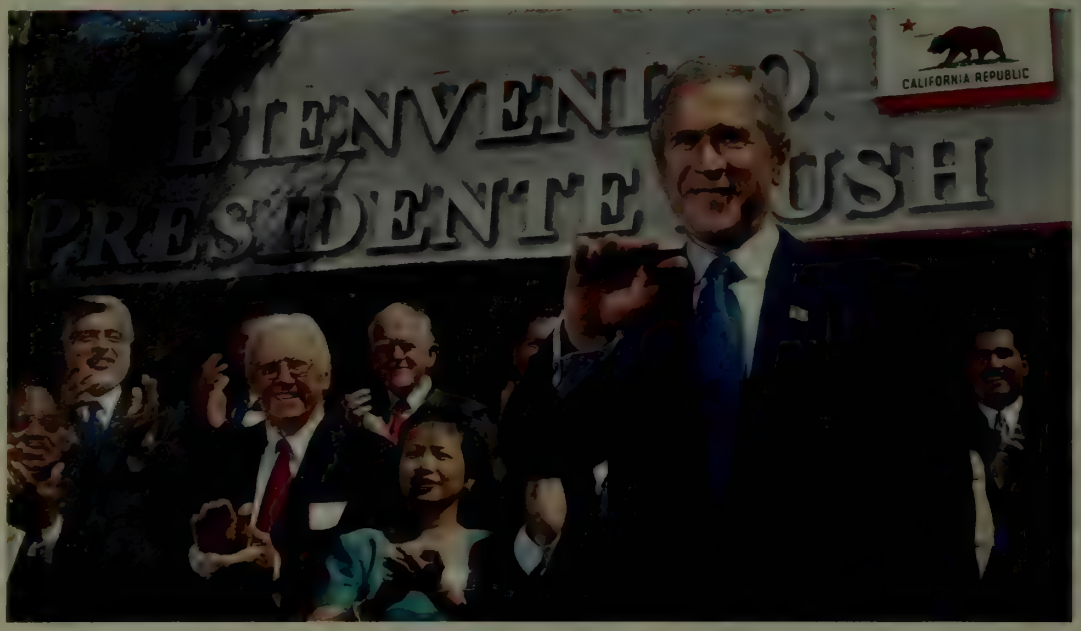
*ASIANS, NATIVE AMERICANS, ETC.
**INCLUDES WHITES

...BUT FEW ARE ON TRACK FOR MANAGEMENT JOBS

COLLEGE GRADUATION RATE BY AGE 26, BY RACE

HISPANICS	11%
BLACKS	17
WHITES	34

Data: Census Bureau, The Aspen Institute, Education Trust



CALIFORNIA, '02: *Bush aims to broaden base*

POLITICS

ANGER ON THE RIGHT, OPPORTUNITY FOR BUSH

Ire over affirmative action makes the President look more centrist

There are times when a little thunder on the Right can be actually good for a conservative Republican President. And given conservatives' dismay over the Supreme Court's affirmative-action decision, this may be one of them. GOP activists, furious at the Administration's timid stance on the issue, are threatening a revolt over the Court's embrace of affirmative-action principles. But at the White House, where President George W. Bush applauded the split decision as a victory for diversity and his goal of a "color-blind society," serenity reigns.

Why? Because an unequivocal High Court ruling to invalidate racial preferences would have roiled the nation's social fabric in the runup to an election year. When the Administration earlier this year filed a brief asking the Court to overturn the University of Michigan's undergraduate and law-school affirmative-action programs, it hedged by saying that diversity was a laudable goal. Using the same rationale, the Court split its judgment, upholding preferences while nixing numerical quotas. That opinion allowed the President to claim a victory without sparking a polarizing revolution. "The [Administration's] brief was muddled at best," gripes conservative activist Gary Bauer. "Now, they're probably breathing a sigh of relief at the White House."

Maybe so, but hard-line conservatives aim to heat things up for the Administration. They are preparing to mount dozens of legal challenges and wage a war of public opinion on the airwaves and at the grassroots. Linda Chavez, president of the Center for Equal Opportunity, which weighed in against affirmative action, already is searching for racially exclusive programs and will shower the Office for Civil Rights and the Education Dept. with complaints. "We will hold the Administration's feet to the fire," Chavez says. If Bush doesn't do the Right's thing, she warns, he risks "dampened enthusiasm" on Election Day.

In fact, all the *sturm und drang* on the Right won't necessarily hurt Bush. His political team is focused on cementing the affections of suburban swing voters in general and working women in particular. Conservative ire gives Bush an opportunity to appear more in the mainstream on diversity, with little danger that it will shake his unprecedented 92% support from h GOP base.

Still, soci conservative vow revenge. They want Bus to atone not just for his actio but for the sins of his fathe who appointed "stealth juris David H. Souter to the Court 1990. Souter, along with Rona Reagan appointee Sandra Da O'Connor, has been an enormo letdown for the Right, often si ing with his liberal Court co leagues on key social issues.

The Right's mantra this yea No more Souters. Arch-conse vatives are determined to di suade Bush from naming Whi House Counsel Alberto R. Go zales—or any other perceiv pragmatist—to the Court. Conserv tives blame Gonzales, who they say squishy on racial preferences, for te pering the more doctrinaire views Solicitor General Theodore B. Olsen the White House's amicus brief in t Michigan case. "There is no room the Supreme Court for any so-call moderate," says Janet L. Folger, pre dent of Faith2Action, a conservati grassroots alliance.

And what of trouble from the middl Liberal civil rights groups plan to spe some $3 million on a campaign to sp light Bush's anti-preferences rheto and his hostility to race-based pla But Bush's political team is betting th critical swing voters—who tell pollste they favor diversity but not strong firmative-action plans—won't be sway "Painting him as an extremist is n going to work," says Robert G. de Po da, president of the La no Coalition, a right-lea ing Hispanic group.

"We will hold the Administration's feet to the fire"

ANTI-AFFIRMATIVE ACTION LEADER CHAVEZ

If Bush plays it we the Michigan ruling cou help him keep a solid lo on mainstream conserv tives, woo suburban swi voters, and maintain carefully nurtured ima as "a uniter, not a vider." After Iraq and messy aftermath, divisi on the home front are t last thing a President f ing reelection wants needs. As for all th grousing on the Right—it's probably m sic to George W.'s ears

By Lorraine Woell in Washing

COMMENTARY

By Rich Miller

WHY GREENSPAN HAD TO CUT RATES

RISKY? If anything, the Federal Reserve wants to cultivate a sky-high bond market

Perhaps no one was as surprised as Alan Greenspan and his central bank cohorts by the success they've had in engineering a big rally in the bond market. Simply by alluding to the risks of deflation, the Federal Reserve convinced investors that buying bonds was a sure thing because interest rates were headed lower.

Now, though, Greenspan & Co. face the delicate task of nurturing that rally and the welcome fall in long-term interest rates that it has created. Bond prices fell sharply on June 25 after the Fed cut short-term interest rates by a quarter percentage point, less than the half-point reduction many investors had been hoping for. The sell-off—which drove the yield on the key 10-year Treasury note to 3.39% from 3.27% before the Fed's announcement—came even though the central bank held out the prospect of further cuts and ratcheted up its rhetoric on deflation. The danger of falling prices, the Fed said, would "predominate" for some time.

The Fed's decision was a difficult one. In a rare dissent, San Francisco Fed President Robert T. Parry voted in favor of a half-point cut. The remaining 11 members of the policymaking committee opted for the quarter point, even though some had suggested privately before the meeting that they were uneasy about reducing rates at all. In fact, with the economy showing signs of picking up, many private economists thought another cut was unnecessary. They argued that it could prove detrimental by pumping up incipient bubbles in bond, stock, and housing prices. Indeed, in its statement, the Fed acknowledged that the economy was looking better and that financial markets had "markedly improved."

But for the Fed, it's not enough that growth picks up to 3% or thereabouts in the second half from under 2% in the first. What the Fed wants is a sustained period of above-trend growth of 3½% or more. Because productivity has stayed so strong, such supercharged growth is needed to restore shattered corporate confidence, bring down unemployment and, most important, dispel the danger of a deflationary downturn in prices and the economy.

As for the risks of bubbles, the last thing the Fed wants to do is repeat the mistake of the Bank of Japan. Wary of reinflating the stock market and property bubbles in Japan, the country's central bank held back for a time from aggressively pumping money into the economy. The result: an extended period of malaise and ultimately a dip into deflation.

That explains why the Fed isn't particularly worried by the risks of a bond bubble; if anything, it wants to cultivate a sky-high market. But keeping bond prices up isn't easy, as reaction to the quarter-point cut showed.

The reason: Much of the bond rally now is built on exaggerated fears of deflation and unrealistic hopes that the Fed will buoy the market by buying bonds. If those hopes and fears dissipate, look out below. "It looks a lot like the NASDAQ runup of the late 1990s and early 2000—dangerous," says Donald H. Straszheim, head of Straszheim Global Advisors Inc.

Although Greenspan & Co. have called the risks of a deflationary downturn remote, their constant harping on the subject has convinced many investors otherwise. "The markets are being inundated by this deflationary schtick," says William H. Gross, managing director of Pacific Investment Management Co., the world's largest bond-management firm. "At some point, that forces investors over the edge, forces them to buy bonds."

Investors also have been induced to jump into the market by hopes that the Fed itself will buy bonds to bring down long-term interest rates and keep deflation at bay. The trouble is, the more Fed officials have studied such a strategy, the more problems they've found with it. They fear that big bond buying by the Fed would just cause distortions in the market without having much economic impact.

So far, the Fed has done a masterful job in managing the bond market. The question now: Can it keep it up long enough to bring about the robust recovery everyone is hoping for?

Miller covers the Fed from Washington.

BOND BONANZA

Data Bloomberg Financial Markets

GOVERNMENT FINANCE

FREDDIE MAC ATTACK

Critics are calling for greater oversight—or even a breakup

Mistakes were made—lots of them. Management controls were weak, disclosures were misleading, and accounting in many cases was flat-out wrong. Despite all that, the company's future is rosy. That was the message from Freddie Mac on June 25, when it announced that an upcoming restatement could total $4.5 billion. "The company remains safe and sound," Freddie Mac Chairman Shaun F. O'Malley declared.

The market, too, focused on the good news: The restatement, expected in September, will boost Freddie's past earnings and increase surplus capital. That raises the possibility of bigger dividend payouts or even a share repurchase to reward stockholders. Freddie's shares rose 1.6%, to $50.83.

But no matter how hard Freddie tries to spin billion-dollar accounting errors, the housing-finance agency's admissions are fueling critics. Freddie made so many mistakes in applying derivative accounting rules that "a majority of the corporation's derivatives in 2001 and 2002 will not qualify as accounting hedges," the company said. And while Freddie Mac will correct financial statements back to 2000, the errors date from the mid-'90s, says new Chief Financial Officer Martin F. Baumann.

Not everyone is as sanguine as the stock market, however. What, for instance, would have happened had Freddie bet the wrong way on interest-rate movements, or if banks, fearing further problems, refused to buy its debt? Freddie's problems reveal just how little is known about its inner workings—and highlight the risks should the markets lose confidence in its ability to manage its huge derivatives portfolio. "Even if they're not trying to cook their books," says Michigan State University accounting professor Thomas J. Linsmeier, Freddie's mistakes show that "ther could be a systemic problem requiring taxpayer bailout."

That's exactly why a small but voc group of banks, politicians, and acader ics for years have argued that Fredd and its larger cousin, Fannie Mae, l subject to tougher regulation, includir Securities & Exchange Commissic oversight. Now, Freddie's revelatio will make it harder—though not impo sible—for either of the two governmer sponsored enterprises to block reform They have also raised anew the questi of whether these giants should be sp up or even privatized.

Freddie and Fannie are crucial co in the housing market because they b mortgages from commercial banks a other lenders and resell them to i vestors as mortgage-backed securitie That frees lenders to lend again. A thanks to the three-year-old housi boom, Fannie and Freddie now car an astronomical $1.6 trillion in asse on their balance sheets, up from $9 billion in 1999. But as Freddie h shown, what lies behind those numbe is often a mystery.

The reason, in a word, is derivative The root of Freddie's problems can found in a dense document call Statement of Financial Accounting Sta dards 133, which determines accour ing rules when derivatives are used hedges. The rules require companies assign current market values to the i terest-rate swaps, options, and oth derivatives they hold and to reflect a changes in their value on the balan sheet. FAS 133 also contains a sweeten Companies can offset any gains (or lo es) on an asset with a similar loss (gain) on the derivative used as a hedg And here's the real grabber: A changes in a derivative's value can recognized over the life of the hedge, lowing companies to avoid the volatili

WHAT WENT WRONG

Freddie Mac says accounting errors will require a restatement of as much as $4.5 billion for 2000-02 earnings. Among the mistakes:

MIXED ACCOUNTS Instead of keeping separate accounts for mortgage securities it planned to keep and those it traded, Freddie mixed the two in a $260 billion pool. It should have booked every swing in value as a profit or loss. Instead, it kept the securities on the books at their original values.

FALSE DERIVATIVES Freddie booked Treasury bills and other cash-like securities as derivatives, which would let it postpone booking any gains. It should have immediately recognized gains and losses on cash instruments.

BAD MODELS Freddie based its values for some option-related derivatives on models, not market prices. Rules call for using market prices when available.

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Smith, by no coincidence a professor of moral philosophy, infused ethics into economics. He asserted the world would be successful if countries pursued what they did best and shared openly. Today, this is the motivating sentiment behind Scottish Development International, helping financial services companies worldwide set up operations here or access the astute sensibility of our financial companies and universities.

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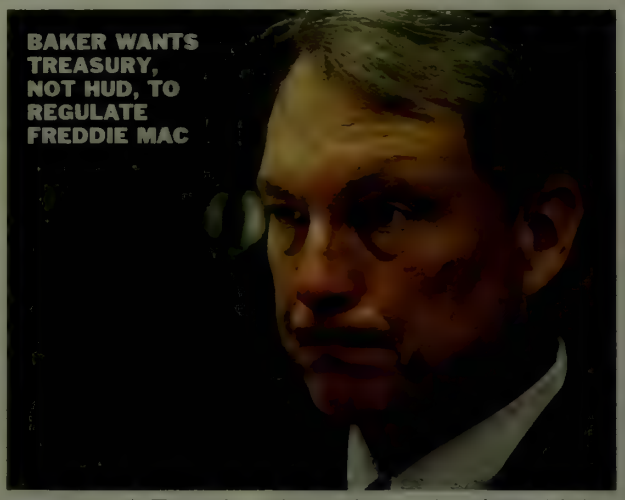
that market-value accounting creates.

The improper use of hedge accounting to amortize gains—and thus smooth ragged ups and downs in quarterly earnings—was Freddie's downfall. As a June 25 press release deadpanned: "Certain capital market transactions and accounting policies had been implemented with a view to their effect on earnings in the context of Freddie Mac's goal of achieving steady earnings growth." Translation: Steady earnings help Freddie convince investors and lenders that management has its eye on the ball. They also help ward off politicians who might point to volatility as a reason to tighten regulation or even break Freddie up.

The company's quest for smooth earnings, plus its admitted lack of accounting expertise and weak management controls, proved to be a fateful combination. That became clear to PricewaterhouseCoopers auditors soon after they replaced longtime Freddie auditor Andersen LLC in 2002. The new audit team soon discovered suspicious hedge accounting involving Treasury securities.



BAKER WANTS TREASURY, NOT HUD, TO REGULATE FREDDIE MAC

Freddie, it turns out, had sought to lock in favorable spreads between the lower interest rate it pays to holders of its debt and the higher rate it gets for the home mortgages in its portfolio. Typically, financial institutions lock in such spreads with standard interest-rate swaps. But in an attempt to lower hedging costs, Freddie used Treasury securities instead of swaps. At the end of 2002, Freddie held some $16 billion in Treasuries on its books as debt hedges.

The net effect was the same—holding Treasuries can protect against interest-rate changes as well as an interest-rate swap. There the similarities end. Because Treasuries are cash instruments, they aren't eligible for hedge accounting under FAS 133. So by designating Treasuries as derivatives and accounting for them as hedges, Freddie violated FAS 133 and now must reverse that treatment by recognizing gains in past years. Although Freddie at the time tried to document the transactions as true hedges, and even got Andersen's O.K., Baumann says: "The accounting was wrong. It just didn't qualify" for hedge treatment.

Once the new auditors dove deeper, they found a disturbing pattern: Most of the derivatives were incorrectly accounted for. Another big error concerns what are called "held-to-maturity," or HTM, securities. Freddie's portfolio includes $260 billion worth of mortgage securities that it classifies as HTM. As long as companies promise not to sell such securities before they mature, they can record them on the balance sheet at their original cost instead of revaluing them each quarter.

But Freddie used some of its HTM securities as collateral for short-term borrowings. It later repurchased the securities, and in doing so, tried to classify the sale and repurchase as a simple repurchase. But once sold, HTM securities do not qualify for hedge accounting. By selling a portion of the HTM portfolio, Freddie tainted its entire $260 billion portfolio. That means Freddie must record any value changes on more than 100,000 securities in either the income statement or shareholders' equity.

Freddie's board and new management team—besides O'Malley and Baumann, it includes former Chief Investment Officer Gregory J. Parseghian as CEO and President—have vowed to put the books in order. They are adding to Freddie's accounting staff and increasing the level of internal oversight. Executives overseeing risk-management functions now report directly to Baumann.

But that won't be enough to mollify critics. Longtime Fannie and Freddie foe Representative Richard H. Baker (R-La.) on June 24 unveiled a measure to move their regulator, the Office of Federal Housing Enterprise Oversight, from the Housing & Urban Development Dept. to the Treasury Dept. and to expand its powers. Treasury Secretary John W. Snow refuses to comment on any specific proposal, but he may be warming to the idea. "[We want] a regime of greater transparency so the investment community will know what's going on," says Snow. Freddie's effort to come clean may be just the start of hard times ahead for the GSEs.

By Paula Dwyer, with Rich Miller, in Washington

THE ECONOMY

SOME GOLDEN STATE

California's dire finances ar a drag on national recovery

He was already California's le popular governor. Now, scarc eight months after winning a n row reelection, Democratic G ernor Gray Davis is fighting to avoi new distinction: California's only sitti governor to be recalled from office. litical activists, whipped up by Califor Republicans, are rapidly gathering 900,000 signatures they need to forc recall vote in November. Among th contemplating a challenge: movie s Arnold Schwarzenegger.

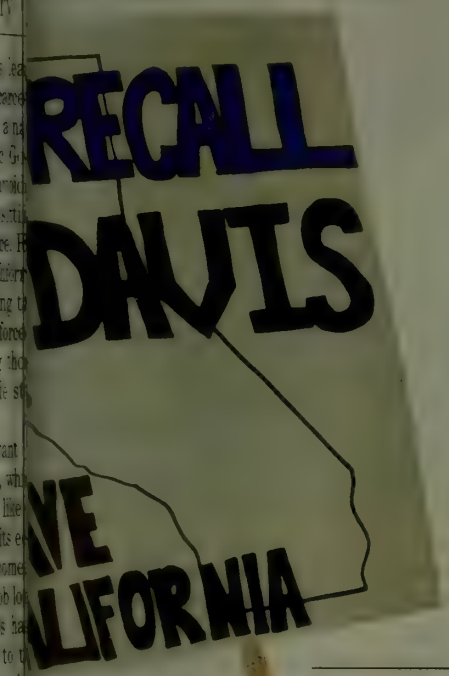
But the Terminator might want think again about that. California, wh only a few months ago looked like would help lift the country from its e nomic woes, has suddenly becom drag on the rest of the nation. Job l es are mounting. Bond agencies h downgraded California's credit to lowest state rating in the country. A legislators in Sacramento, embolden by the drive to force Davis out of off are enmeshed in a bitter partisan ba that is paralyzing efforts to clos yawning $38 billion deficit.

With California accounting for an timated 13% of the country's ove economic activity, the state's proble threaten to slow the national recov California has lost 54,000 jobs this y one-fifth of all pink slips in the co try. In May, the country as a wh would have gained 4,500 jobs if not the state's 21,500 layoffs. "Nationa we're groping for a bottom," says J Kyser, chief economist for the Los geles County Economic Developm Corp. "In California, it looks like w sliding back down."

So why is California still struggli Despite signs of new orders and creasing profits, the tech industry still a sore spot. The state has more than 12,000 technology jobs year, part of the torrent that has cluded more than 220,000 tech positi

ice state employment peaked in December, 2000. Typical is Milpitas (Calif.)-sed Solectron, a major assembler of rdware for companies like Sun Mi-osystems and Cisco Systems. Now s than halfway through a 16% re-ction of its 75,000 workforce, it's shift-g more work to Asia from higher-cost ces like California. "We are winning w business," says Kevin O'Connor, lectron Corp.'s senior vice-president human resources. "But the cost essures remain."

Tech industry consolidation also con-ues to depress the job outlook. ewlett-Packard Co.'s acquisition of



mpaq Computer rp. cost 16,800 s, many of them in lifornia. A merger ween Oracle Corp. l PeopleSoft Inc. uld involve thou-nds more. "Tech is ck, but with produc-ity increasing at 2% year, businesses don't ed to add to their em-yment," notes Esmael ibi, director of the Ander-n Center for Economic Research at apman University in Orange, Calif. For a while, the widely diversified lifornia economy was better able to ather the tech slump. As tech em-yment fell, new jobs emerged in nebuilding, mortgage lending, and a ldenly resurgent Southern Califor-defense industry. But while those tors remain strong, others have akened. Demand for professional vices such as accountants, design-ers, and building managers has fallen along with the decline in technology employment. More important, budget pressures have eliminated 27,900 jobs this year in state and local government, a big source of growth in years past. Even the trend toward lightly staffed reality-TV shows may be playing a role: Some 2,400 fewer people are employed in movie and television production so far this year, a 2% decline.

DAVIS: *Blasting "partisan mischief"*

Much as they did in the early 1990s, the tough economic times are exposing California's intrinsic economic weaknesses, namely sky-high taxes as well as soaring utility, insurance, and other business costs. While the cost of workers' compensation insurance has jumped 50% in the U.S. over the past three years, rates have nearly doubled in California over the same period. Since the Golden State's allowances for procedures like chiropractic care and day surgery are far more generous than those in other states, insurers have been fleeing the market. And while proposed settlements between state regulators and California's two largest utilities should lower electric rates, they will remain 50% above national averages.

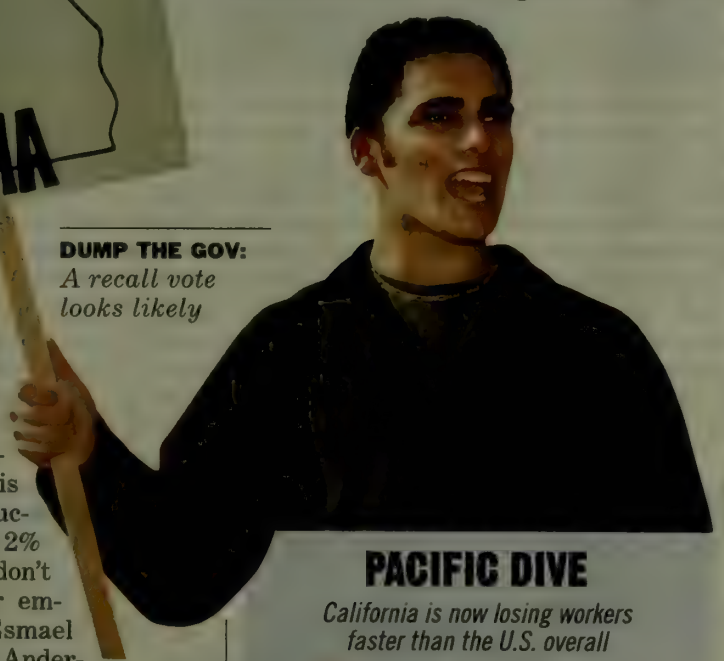
Such conditions threaten a new exodus from a state long criticized for its high cost of doing business. Fidelity National Financial Inc., the nation's largest title insurer, is in the process of relocating its 450-employee headquarters to lower-cost Jacksonville, Fla. Home-lending giant Countrywide Financial Corp. has said it won't increase its 15,000-person workforce in California unless legislators do something about what it considers overly generous overtime, insurance, and family medical leave laws. "We love California," says Leora Goren, Countrywide's managing director of human resources, "but it would be irresponsible to build in the state with the incredible costs."

Given the stalemate in Sacramento, the business climate is likely to get worse before it gets better. State legislators missed a self-imposed June 15 deadline to pass a budget. Eager to build their case for recalling Davis, state Republicans are blocking his half-percentage-point sales tax increase, which would raise an estimated $2.3 billion. They're also threatening to go to court to block another big hike in the state's vehicle registration fees.

Whatever budget compromise ultimately emerges, it will almost certainly involve new taxes and reductions in state spending, both of which would act as further drags on California's economy. "Businesses' worst fear is that inaction will force more severe tax increases, making California an even worse place to do business," says Ross DeVol, director of regional economics at the Milken Institute, a Santa Monica (Calif.)-based think tank.

All of this means a bitter inheritance for Davis' successor, should it come to that. An estimated 51% of voters would vote to recall the second-term governor, according to a recent poll by the nonpartisan Public Policy Institute of California. That has sent Davis back to the stump, where he is blasting the recall effort as "partisan mischief by the right wing." It may make for slam-bang entertainment in the film industry's home state. But if California continues to hemorrhage jobs, even the Terminator would find it hard to blast his way out of this mess.

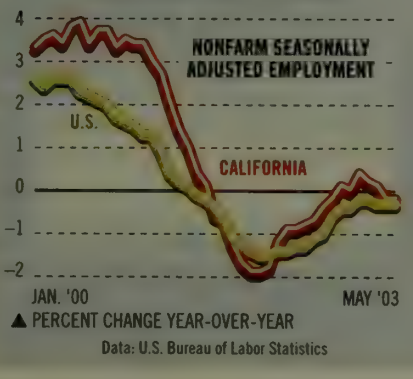
By Christopher Palmeri and Ronald Grover in Los Angeles



DUMP THE GOV: *A recall vote looks likely*

PACIFIC DIVE

California is now losing workers faster than the U.S. overall



Data: U.S. Bureau of Labor Statistics

In Business This Week

EDITED BY MONICA ROMAN

MY PHONE NUMBER GOES WHERE I GO

ODDS ARE IMPROVING THAT consumers will be able to keep their wireless phone numbers when they switch carriers. Companies have been lobbying against so-called wireless portability, which the Federal Communications Commission has ordered them to adopt by Nov. 24. They fear customers will switch carriers more often, triggering a price war. But Verizon Wireless broke ranks June 24 and embraced the change. Verizon, the nation's wireless leader, said it would not impose new fees to cover the cost of implementing the rule. That puts pressure on others to follow its lead.

COME BACK, LITTLE SATURN

GENERAL MOTORS' SATURN DIV. can't seem to catch a break. The money-losing subsidiary decided to recall 254,000 of the slow-selling L-Series sedans on June 20 because of problems with the engine and ignition system. The car had a tendency to lose power or could be difficult to start. In a few cases, the car has caught fire. GM says that the repair job takes 30 minutes on each vehicle and that it will pay Saturn retailers for the work. "Unfortunately, recall campaigns are part of the business," says Jill Ladjiak, Saturn's vice-president for sales and marketing. Saturn has been known for high quality, but this year the brand fell to near the bottom of the J.D. Power annual initial quality survey.

WARDING OFF PROSTATE CANCER

ON JUNE 24, THE NATIONAL Cancer Institute reported that the Merck drug finasteride could reduce the risk of prostate cancer in healthy men by 25%. Finasteride is sold as Proscar for enlarged prostates and Propecia for male-pattern baldness, and combined sales are currently about $550 million a year. Analysts say sales might soar if the drug is approved for cancer prevention, but the study contained many caveats. For one thing, those men taking the drug who did develop cancer were more likely to have a more aggressive form of the disease than those on a placebo, for reasons researchers couldn't explain.

CLOSING BELL

LEAP OF FAITH

USG may be bankrupt, but there's still plenty of life left in the wallboard maker's stock. Buoyed by Senate committee action that would limit asbestos liabilities, investors bid up Chicago-based USG shares 46% in two days. The stock closed at $19.06 on June 25—its highest price in 28 months.

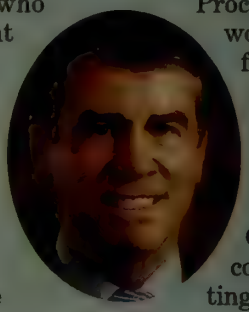
'WORLD'S FASTEST PC'

STRIVING TO KEEP THE INNOvator mantle in the computer business, Apple Computer CEO Steve Jobs on June 23 unveiled several new products, including a machine he described as the "world's fastest personal computer." Dubbed the G5 PowerMac, the unit will boast more computing horsepower than any PC on the market when it ships in August, according to analysts. Jobs also previewed Apple's new operating system, code-named "Panther." The release thrusts Apple into the Internet video- and audio-conferencing businesses by coupling instant messaging technology with audio and video capabilities. "It's video conferencing for the rest of us," said Jobs.

HEADLINER: GERALD JOHNSTON

MEET THE NEW CAPTAIN OF CLOROX

CLOROX HAS TAPPED A 22-year veteran in a bid to brighten its prospects. Gerald Johnston, who had been president and COO since 1999, takes over as CEO on July 1 from G. Craig Sullivan, who will remain chairman until yearend.



On June 18, the day before the appointment, Clorox estimated that fiscal fourth-quarter profits would come in between 67¢ and 68¢ a share, the low end of its previous forecast. The company blamed the poor results on rainy weather, which depressed sales of its Kingsford charcoal and Armor All car products.

Johnston joined Clorox in 1981 after 10 years with Procter & Gamble, working his way up from national sales manager fo the Kingsford di vision. He told analysts that he will continue the Oakland (Calif.) company's cost-cut ting drive, which has helped boost profits in recent quarters.

"He'll retain the status quo, and that's good, because the restructuring is working," says CIBC World Markets analyst Joseph Al tobello. Next step: sprucin up slow sales growth with new products.

Robert D. Ho

BALKING AT A BIOTECH MERGER

FOR SEVERAL WEEKS, INVESTors have been scooping up biotech stocks in anticipation of several new drug approvals. But they balked at the planned merger of Idec Pharmaceuticals and Biogen. The all-stock deal, announced on June 23, is the largest biotech merger since Amgen acquired Immunex for $11 billion in 2001. The comp nies would have combined nual revenues of $1.6 billi and they expect to save $ million in expenses throu 2007. But heft does not sure compatibility. The co panies have very different search strengths: San Dieg Idec markets cancer dru while Biogen, based in Ca bridge, Mass., specializes autoimmune disease. Jitte investors pushed down shares of both Idec and B gen by 6% the day after announcement.

ET CETERA...

- Tenet Healthcare warr that second-half profits wo fall short of expectations.
- Vivendi's board is expec to meet on July 1 to cho among the bids for its U entertainment properties.
- The recording industry tr group plans to sue Inter song swappers.

EDITED BY MIKE McNAMEE

BUSH'S FREE-TRADE DIPLOMACY HAS CORPORATE AMERICA STEAMING

The Bush Administration has a new weapon in the war against terrorism: offering free-trade deals to allies from Australia and Morocco to the tiny Persian Gulf emirate of Bahrain. But the GOP's business allies aren't impressed. They complain that such grand diplomacy makes for poor trade policy. Sensing a way to mend frayed ties to well-heeled business groups, Democrats are taking up their cause.

This fall, the Administration intends to start talks on a deal with Bahrain, which supported the Iraq invasion and hosts the U.S. Navy's Fifth Fleet. And on June 23, President Bush dispatched U.S. Trade Representative Robert B. Zoellick to the Middle East to kick off a 10-year drive for a regional free-trade zone, pointedly excluding unfriendly Iran and Syria. The idea is to reward friends, enhance economies, and spread the free-market gospel.

That's nice, says Big Biz, but what about the bottom line? Two-way trade between the U.S. and Bahrain was a mere $800 million last year, about what the U.S. and Canada ship to each other every 18 hours. "Now that we've given trade such a high economic priority, we shouldn't be using trade to promote other objectives," says Calman J. Cohen, president of the Emergency Committee for American Trade, which represents the largest U.S. exporters. The National Association of Manufacturers, the U.S. Chamber of Commerce, and the Business Roundtable are also dismayed.

ZOELLICK: *Juggling too many deals?*

Corporate America has a point. Zoellick's 135 negotiators are already spread so thinly among big multinational talks that the agency is considering teleconferences. Free-trade pacts with individual countries require months of tedious negotiations and, in the case of developing nations, a rewrite of each country's intellectual-property and investment laws—all other distracting the USTR. The deal with Chile, for example, runs to 800 pages and took more than two years to complete.

Business fears that the battle to win fast-track negotiating authority for the President will have all been for naught if the Bushies don't concentrate on high-value partners. "Now, we're going to have more negotiators working on little Bahrain than on talks with China," says Howard F. Rosen, former executive director of the Competitiveness Policy Council, a Washington think tank.

Dems are relishing the chance to be more pro-business than the GOP as they demand a shift in Administration priorities. "You need to get the most bang for your buck, and there are countries with much greater economic potential" than Morocco or Bahrain, says Max Baucus (Mont.), senior Democrat on the Senate Finance Committee. He has called for a General Accounting Office investigation into negotiating priorities.

Business groups are drawing up their own wish list for free-trade deals, focusing on countries such as Thailand and Taiwan. Not only do those two together already buy $24 billion in American goods, but U.S. corporations are eager to build plants there to export throughout Asia. Investment guarantees typically built into a free-trade deal would speed that process.

To appease business constituents, the Administration is apparently willing to jump Thailand to the head of its list. But it won't concede that it has misplaced priorities. "We are not pushing better opportunities aside," insists USTR General Counsel John Veroneau. "Trade agreements also promote the rule of law and the political stability that reinforce U.S. national security goals." Maybe. But with manufacturing in a three-year slump, Corporate America would rather have its needs—not diplomacy—as trade strategy's Job One.

By Paul Magnusson

CAPITAL WRAPUP

THE EPA'S NEW BOSS?

As battered Environmental Protection Agency head Christine Todd Whitman heads for the exit, the White House is having trouble filling her job. With swing voters so vital to the coming election, a polarizing James Watt type wouldn't suit Bush political maestro Karl Rove. On the other hand, conservatives are primed to oppose another moderate for EPA, since they considered Whitman a Democrat in expensive sheep's clothing.

A possible solution: Appoint a genial politician who visits parks yet deregulates with a fervor that pleases pro-growth Westerners and U.S. industry. That may be why the name of Idaho Governor Dirk Kempthorne is being floated. In his six years in the Senate in the '90s, Kempthorne sided with enviros only once in 71 votes. But both Kempthorne's detractors and boosters say the governor is a superb communicator. "He's the best I've ever tested," says Frank I. Luntz, a GOP pollster whose memos on language have helped Republicans shift from angry Newt-speak to Bushian compassion-chatter. "In focus groups, people said that he looked like Paul Newman and talked like Robert Redford."

Another boon for Kempthorne: As a Senate alum, he's likely to win confirmation, particularly because he sat on the panel that will vet him. But whomever is tapped, Democratic Presidential hopefuls—such as Senators John Kerry (Mass.), John Edwards (N.C.), and Joseph I. Lieberman (Conn.)—are likely to use the appointment to attack Bush's enviro policies.

By Alexandra Starr, with John Carey

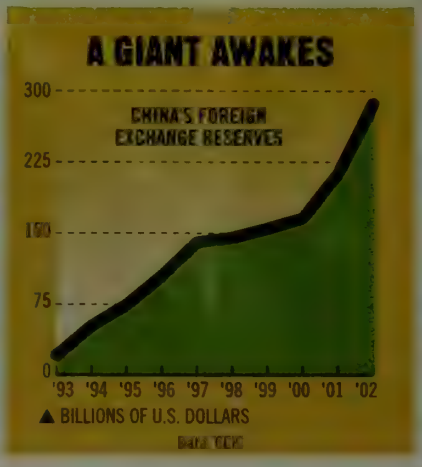
CHINA

WILL CHINA REVALUE?

It's facing heavy political pressure to act

Business couldn't be sweeter for Shen Guiping. The marketing executive at Hisense Co., a $2.3 billion consumer electronics manufacturer in Qingdao, China, says his company expects $100 million in exports this year, easily hitting its 80% growth target. An end to antidumping duties on Chinese TVs in Europe last year helped. But a more powerful boost to Hisense and thousands of other Chinese manufacturers is the country's weak currency, the yuan, which is pegged to the flagging U.S. dollar. The greenback's 11% drop against the euro this year makes Chinese exports more competitive against European goods. "We have very bright prospects," says Shen.

What's good for Chinese manufacturers, however, is raising howls of protest elsewhere in the world. Currency analysts such as Montreal's BCA Research regard the yuan—pegged at around 8.3 to the dollar for a decade—as undervalued by 20%-30%, given China's swelling foreign reserves, which leapt by 35%, to $286 billion, last year. Now, with the yuan even cheaper thanks to the dollar's dive, China's export machine is really roaring—at the expense of Japan, Mexico, South Korea, and other nations with floating currencies. U.S. manufacturers also claim they're being hurt by an artificially cheap yuan. In May, China's exports surged 37% above last year's levels, despite tepid growth in the U.S., Europe, and Japan. Beijing University economist Song Guoqing expects China's exports will be up 30% for the year, to $424 billion.



This success is sparking renewed calls for Beijing to revalue the yuan, or even let it float. And there are indications that the jawboning may be having an effect. On June 16, U.S. Treasury Secretary John Snow stoked speculation that Beijing may make a move by saying Chinese leaders had indicated "that they intend to create more flexibility" in the currency.

Seoul has intervened in currency markets to limit the won's rise against the yuan, which hurts Korean manufacturers of everything from textiles to cell phones. "The Chinese currency needs to strengthen," says economist Kang Sam Mo of the Korea Institute for International Economic Policy, a government-funded think tank. China ran a $103 billion trade surplus with America in 2002. Washington's National Association of Manufacturers says the politically sensitive gap could hit $330 billion in five years if historical trends continue.

But absent a big political push by Washington, hopes for a Chinese revaluation may be misplaced. The reason: Exports are one of the few brights spots in the Chinese economy. After gangbuster 9.9% growth in this year's first quarter, the economy is slowing. The deadly severe acute respiratory syndrome (SARS) epidemic slowed consumer spending this spring at a time when the economy was already decelerating from a cyclical peak. If it weren't for SARS, s economist Song, Beijing might ha revalued the yuan modestly this su mer. "But the economy's strength l shrunk," says Song. "For now, the g ernment wants to keep the peg and s what happens next."

What's more, the Chinese econo is in the midst of a painful transiti Private estimates put unemployment high as 15%. And joblessness is risi as Beijing continues to restructure ag culture and close state enterpris Meanwhile, Beijing is trying to put t brakes on new lending after allowi bank loans to soar by 34% in the p two years, an unsustainable pace.

The easy-money strategy has work wonders in propelling economic grov since the 1997 Asia crisis and throu several years of domestic deflation. I it has come at a cost. China's $1.8 t lion in outstanding bank loans are eq to 140% of its gross domestic produ compared with 88% in 1996. And n performing loans are high at Chi

ur major banks, all of which are tech-
cally insolvent. Since 1998, Beijing has
ent $200 billion to recapitalize banks
d take over bad loans. Standard &
or's estimates that a further $500 bil-
n is needed. The lending spree also
s fed a real estate bubble that Beijing
trying to gently deflate. In mid-June,
China's central bank issued new
curbs on property lending.

Given its precarious finances, Beijing is wary of doing anything to hurt exports. Morgan Stanley chief Asia economist Andy Xie warns a currency revaluation might "destabilize" the economy by encouraging greater capital inflows that would further juice the overheated property sector.

Washington is also performing a delicate balancing act. That's because China is now second only to Japan in purchases of U.S. Treasury bonds. Its holdings of Ameri-
n debt have risen from $82 billion a
ar ago to $119 billion, according to
e Treasury. Washington wants to be
re China keeps recycling foreign ex-
ange earnings into U.S. government
per. Treasury Secretary Snow told
usinessWeek he expected China to
sen its currency "as part of an over-
package of reforms." Snow said a
dening of the yuan's trading band
uld be favorable but should be "cou-
ed with banking reforms and greater
ansparency."

Political pressure may force China to
value at least a bit—perhaps 2.5% to
, analysts say. If U.S. unemployment
mains high in the runup to the No-
mber, 2004, election, expect more
essure from Snow and other U.S. of-
ials. China's rising trade surplus is
re to draw more attention, given that
e U.S. has lost 2 million manufactur-
g jobs, 10% of the total, in the past
o years, according to the NAM. "We
st press China to end the manipula-
n of its currency and allow the yuan-
llar exchange rate to be determined
the market," NAM Vice-President
anklin J. Vargo said at a congres-
nal hearing in May.

It would take more than a modest
valuation to slow China's export jug-
rnaut, though. So while a quick reval-
tion might look politically astute, it
uld not avert a trade showdown.

By Mark L. Clifford in Hong Kong
th Dexter Roberts in Beijing

COMMENTARY

By Brian Bremner

HOW JAPAN KEPT A LID ON THE YEN

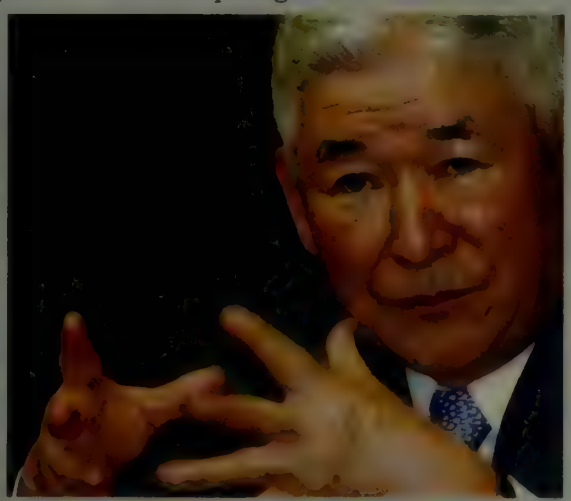
After a decade of anemic growth, an apparently endless banking crisis, and creeping deflation, Japanese economic officials have become the butt of more than a few jokes. But when Tokyo this year sensed the dollar's decline against major currencies, it didn't kid around with half-measures. The Bank of Japan stepped in with $50 billion in currency interventions, keeping the yen remarkably stable against the greenback.

Along the way, Japan's money mandarins have earned the grudging respect of currency traders in New York, Tokyo, and London, many of whom were betting that the yen would appreciate to crushing levels, throttle export growth, and push Japan back into recession. Despite the dollar's 11% plunge against the euro, the yen has barely budged. As of June 24, it stood at 118 to the buck—just 1% stronger than it was in January.

Given Japan's dismal economy, no one was predicting a superpowered yen this year. But the surprising recovery of Japanese shares—the Nikkei average is up 17% since April—has attracted some $16 billion in foreign money to the Tokyo exchange in the past two months. Moreover, during the first two weeks of May, a wave of dollar-selling driven by record-low U.S. interest rates and slack economic growth pushed the yen up 3.6%, to about 115—the level at which Japanese exporters start to yelp about declining profits. "If the yen had popped up to 100 or so, you'd probably be looking at a recession by the end of the year," figures ING Baring Securities (Japan) Ltd. economist Richard Jerram.

With Japanese export growth the only thing keeping the economy afloat, Finance Minister Masajuro Shiokawa and Bank of Japan Governor Toshihiko Fukui decided to send a decisive message to currency traders: Bet long on the yen, and you'll get knee-capped. Fukui's currency team started buying greenbacks. The BOJ snapped up a cool $16 billion in the first quarter alone and recycled much of that into U.S. Treasury bonds to bolster the buck. And Japanese officials, normally tight-lipped on interventions, wanted to scare off any traders who might still be gambling on a surge in the yen. In April, the government blurted out exactly how much it had spent so far—and promised much more to come.

Sensing a bluff, traders started buying. At the same time, U.S. Treasury Secretary John W. Snow made comments the market understood to mean he was ready to let the dollar slide as a way to goose U.S. export growth. So the BOJ pulled out the big guns, buying nearly $35 billion in May and the first half of June. At the same time, the bank smartly timed its interventions to get the maximum bang for the buck. "They leveraged all their trades" to the max, says Barclays Global Investors currency strategist Masahiro Fukuhara.



STALWART Fukui fended off traders by buying billions of dollars

An added benefit: Even as the yen has stayed steady against the dollar, the euro is up by 10% vs. the yen so far this year. That's great news for Japanese companies such as Toyota, Mazda, and Sony, which ship products to the euro zone. So for once, at least, the wags in the international financial community can keep their chuckles to themselves. In the currency war of 2003, Japan's financial bureaucrats have won hands-down.

Bremner reports on Japanese finance from Tokyo.

BRITAIN

STILL IN THE HUNT

Despite the ad slump, WPP keeps pursuing new prey

WPP Group CEO Martin S. Sorrell knows a bargain when he sees one. Over 17 years, his dealmaking finesse—he has acquired or made major investments in 30 companies in the past two years alone—has built WPP into the world's second-largest advertising and marketing services company. His latest target: Cordiant Communications Group PLC, the struggling British advertising agency for which Sorrell bid $442 million on June 19. It's easy to see why Sorrell covets Cordiant. The two companies share a host of big-name clients, such as Pfizer, Heineken, and Johnson & Johnson. Cordiant also owns valuable operations in Asia and Latin America, regions where Sorrell wants to expand, and boasts an expertise in growing fields such as health-care communications and direct marketing. "Cordiant will help us strengthen existing client relationships and further our strategic goals," says Sorrell.

But the battle for Cordiant is shaping up to be tougher than anyone, including Sorrell, expected. Although Cordiant's board and a majority of its debt holders have agreed to WPP's takeover, Cordiant's largest shareholder, British fund manager Active Value, may stymie Sorrell's plans. On June 24, Active Value, which is nursing $58 million in losses from its investment in Cordiant, upped its stake to 24.53%, just short of the 25% required by Lond Stock Exchange rules to block a takeover. While Active Value declin to comment, sources familiar with t deal say the fund manager is unhap with the paltry $16.6 million in w shares being offered to Cordiant's equ holders. The remainder of WPP's $4 million bid for Cordiant is being offer to bondholders. Cordiant's shareholde have watched the stock fall from $6.79 the March, 2000, peak to around 3¢ day. "This is a cheap deal that adds v ue for WPP's shareholders," says Antho de Larrinaga, a me analyst at SG Equi Research in London.

Cordiant, with or $498 million in re enues after accounti for client losses and set disposals, is ti compared with the $ billion WPP. But w ning it will secu WPP's size advanta over Interpublic Gro of Cos.—plus its N position in the glo ad industry—and h Sorrell achieve his a bitions to offer clients a broader range services in more countries. Sorrell h built WPP into a one-stop communi tions giant, cross-selling services fr advertising to market research to a r ter of blue-chip clients such as Fo Nestlé, and SAP. Sorrell hopes to r up growth by expanding WP reach in the fast-growing c sumer markets of Asia a Latin America. Buying C diant, which has a major pr ence in both markets through Bates Worldwide unit, wo enhance WPP's position a help meet Sorrell's goal of riving one-third of revenu from Asia, Latin Ameri the Middle East, and Afri up from 20% now.

At the same time, Sorr is focusing more of WP

GLOBAL AD AGENCIES: The Big Four

	2002 REVENUES	2003 REVENUES*
	BILLIONS	
OMNICOM GROUP	$7.5	$8
WPP GROUP	6.5	7**
INTERPUBLIC	6.2	6.1
PUBLICIS	3.4	4.7

*Estimate **Includes Cordiant
Data: Company reports, Blaylock & Partners LP, SG Equity Research

SORRELL COVETS CORDIANT

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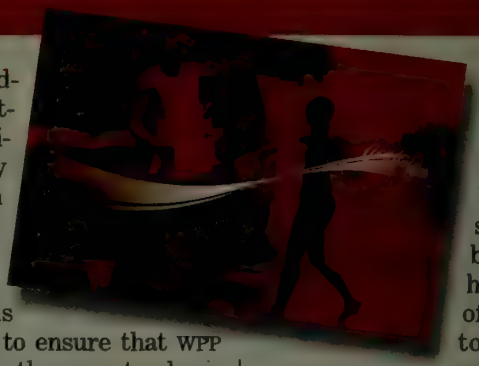
business on marketing services such as public relations, branding, and market research. WPP may have made its name in advertising—it owns some of the industry's biggest names, including Ogilvy, J. Walter Thompson, and Young & Rubicam—but marketing services are its bread and butter, accounting for 53% of overall revenues. Because these businesses are entirely fee-based, they offer a more predictable revenue stream that will help cushion WPP from future downturns in the more cyclical ad business. Sorrell's goal is to generate two-thirds of WPP's revenues from such nonadvertising businesses within 5 to 10 years. He also wants to bolster revenues from hot growth areas such as direct marketing and Web-based communications. Thanks to the falloff in global equity markets, Sorrell expects to find a number of acquisition opportunities in these areas. "Clients increasingly are looking for justification of their advertising and marketing services expenditure, which is why the market research tools we supply will become more important," Sorrell says.



A WPP PRINT AD FOR COKE

It's an ambitious but shrewd strategy to ensure that WPP keeps its edge after the worst advertising market in decades. The past two years have been tough for both WPP and the industry in general. The slowdown in the global economy hit advertising companies hard as clients took a knife to costs. Advertising and marketing were often the first parts of the budget to be scrapped. In 2002, WPP's revenues fell 3% and pretax profit plunged 19%, to $666 million. And this year isn't much better. Sorrell expects no growth before business picks up again in 2004.

Within the i
dustry, he has
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lately, Sorrell
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he believes a numb
of trends are comi
together that bo
well for WPP. "In
low-inflation, relative
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economy where there is very little pr
ing power, companies need to find ne
ways to differentiate themselves in
undifferentiated market," he say
"What we do is becoming more impo
tant." Now, with the first signs of li
emerging in the long-moribund ad ma
ket, WPP is well placed to benefit—wi
or without Cordiant.

By Kerry Capell in Lond

MARTIN SORRELL ON THE AD GAME

The advertising industry has suffered more than most from the prolonged economic downturn. Worldwide advertising fell 7% in 2001, the first decline in two decades; 2002 wasn't much better. WPP Group CEO Martin Sorrell was among the first to predict that conditions weren't likely to improve until 2004. London correspondent Kerry Capell sounded him out on what the future holds.

What's your outlook for the advertising business?

This year, we're expecting advertising and marketing services to be flat. But in 2004, U.S. Presidential elections, the consequent strong economy, the Olympic games, political advertising, and the European football championships should ensure that advertising and marketing services will grow by 3% to 4%.

Have companies cut costs too much?

Price promotion strategies have become more prevalent in some industries. One example is the auto and truck industry, where marketing is focused on zero-coupon financing and cash givebacks. But if you focus too much on price, you end up selling commodities. If you focus on innovation and product, you earn a price premium and build brands. I cannot remember a time in the last 25 years when clients have been so focused on cost.

Longer term, you're optimistic about the prospects for advertising and marketing services. Why?

The underlying long-term trends of globalization or Americanization, overcapacity and the shortage of human capital, the Web, internal communications, and concentration on distribution will underline the importance of our skills and ensure that communication services as a proportion of gross national product will bust through the highs of 2000. The single biggest issue facing our clients is overcapacity, making differentiated products and services critically important.

How has globalization affected the advertising business?

The idea that globalization would lead consumers to buy goods and services the same way everywhere now looks to be flawed. Truly global products and services such as soft drinks or computers only account for about 15% of WPP's revenues. What has been going on may not have been globalization but the Americanization of markets. If you wish to build a global brand or business, you have to dominate the American market. In most lines of business, the U.S. market accounts for almost half of the volume, and failure to understand this can be life-threatening. American hegemony is based on the relative homogeneity of its 280 million population compared with, for instance, the 500 million population of the enlarged European Union. There really is no such thing as a Euro-consumer. Of course, China, with its population of 1.3 billion, is clearly a countervailing force, along with the rest of Asia Pacific. Greater China is already WPP's fifth-largest market.

Will the consolidation among advertising agencies continue?

Yes. Despite lower levels of general merger-and-acquisition activity, consolidation continues amongst clients. New legislation in the U.S., Britain, Brazil, and other parts of the world is spurring consolidation of media owners, and, as a response, everyone from the ad agencies to retailers are following suit. ■

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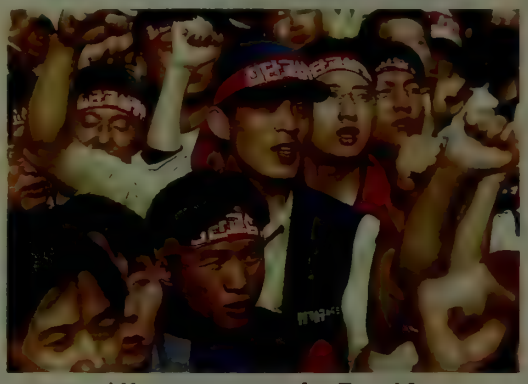
SOUTH KOREA: CAN ROH HANDLE A SUMMER OF STRIKES?

A summer of discontent is brewing in South Korea, presenting President Roh Moo Hyun with what may turn out to be his biggest domestic political challenge since his February inauguration. Just a few days after Roh's government intervened to end an illegal strike that sparked a panicky run on the country's fifth-largest bank, some 10,000 workers at Hyundai Motor Co. walked off the job for four hours on June 25. That stoppage is expected to be followed by an all-out strike starting on July 2, for a shorter workweek, higher wages, and other demands. "We will fight a proxy war with company management," declares Chang Kyu Ho, a leader of Hyundai Motor Union.

Summer is the season for wage bargaining in South Korea, but the level of labor tension is far greater than at any time in recent years. Railway workers, bus and taxi drivers, and shipbuilders are all contemplating walkouts in coming weeks. The unions sense weakness in the inexperienced President, who has publicly expressed helplessness in dealing with the pressures of his office. How Roh handles the strikes could determine whether he is seen as an effective leader—or as hopelessly lost amid demands of competing groups. Other special interests, from farmers to environmentalists, are watching the President's response as "a litmus test," says Choi Kyung Soo, a fellow at Korea Development Institute, a state-funded think tank.



SEOUL: *All eyes are on the President*

Businesspeople fear that if Roh fails to contain the labor unrest, other disgruntled groups will take to the streets. That would exacerbate a mounting sense of crisis and further damage the economy, which contracted 0.4% in the first three months of this year. "Labor militancy discourages businessmen from making fresh investments," says Yoon Byung Chul, chairman of Seoul-based Woori Finance Holding Co. He heads a group of 170 bankers, businesspeople, and scholars who r cently issued a statement warning of the dangers of soci conflict. On June 23, five Big Business lobbying groups also sued a statement saying that companies "will have no choi but to relocate bases to places where we can secure compe itiveness" if the business climate deteriorates further. other words, they might move manufacturing to China.

So all eyes are on Roh. The former human-rights lawy has vowed to uphold the country's labor laws, which requi unions to give 10 to 15 days notice before striking and allo workers to strike only over wages and working conditio The trouble is that there are gray a eas, and Roh's instinct is to interve to carve out deals between manag ment and unions, as he has done ready for striking truckers, railw workers, and teachers' unions. Such i terference is anathema to manageme To end a two-month strike at powe equipment maker Doosan Heavy I dustries & Construction, for examp Roh's government pressed the compa to pay striking workers—a reversal no-work, no-pay principles that are e shrined in the labor law. "Such an a proach gives a wrong signal to union says Seoul National University labor economist Kim Dae

The question is whether rising labor tension will spur R to take a harder line with the unions, which backed hi strongly in his presidential bid. The betting in Seoul is pro ably not, particularly since Roh needs to gain support for h Millennium Democratic Party in advance of National Asse bly elections next spring. A lukewarm response to strik may win him union votes, but if South Korea's competitiv ness deteriorates, the cost of equivocation could be mo than the country can afford.

By Moon Ihlwan in Seo

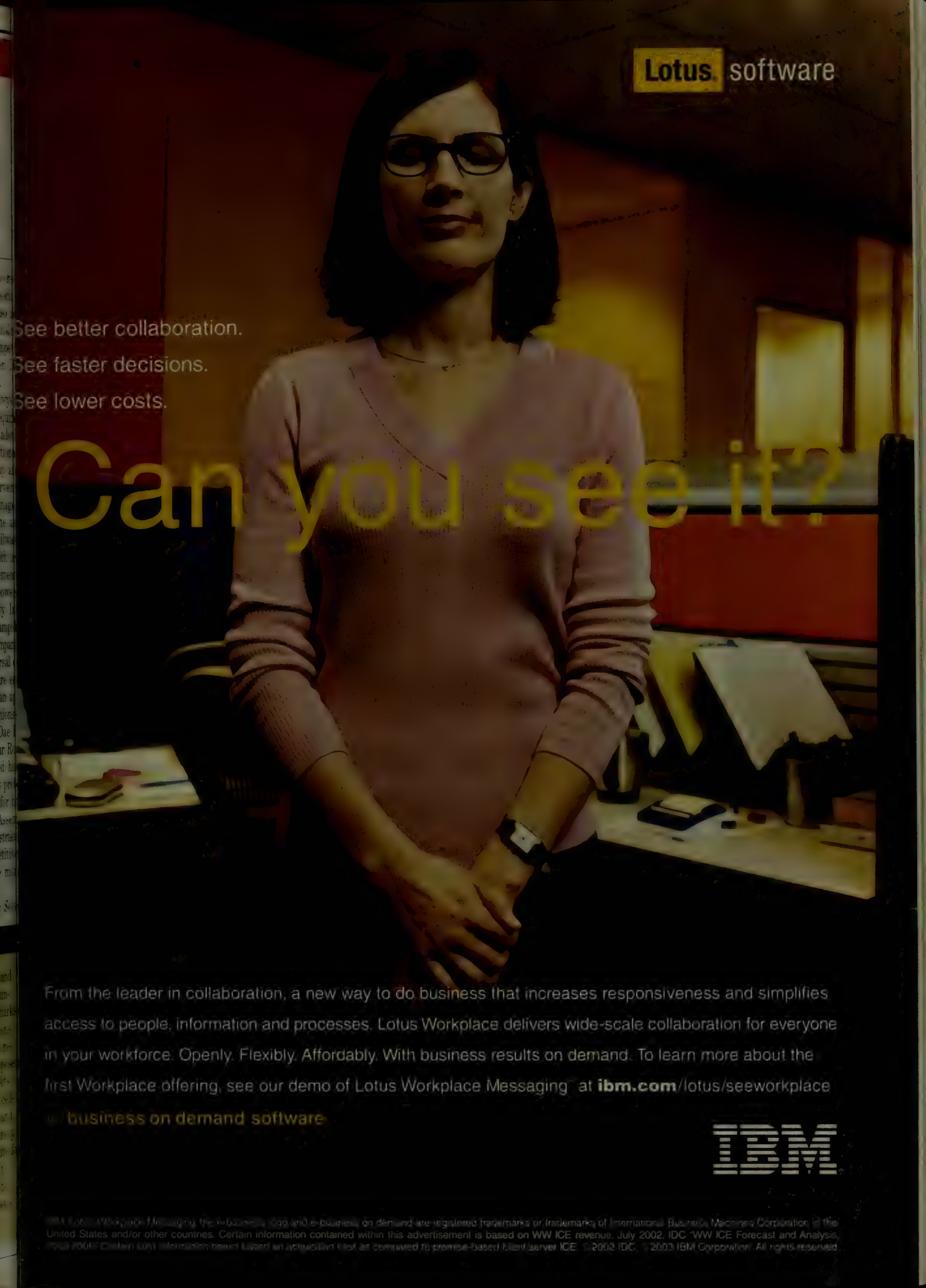
GLOBAL WRAPUP

BANK SHAKE-UP IN GERMANY?

▶ Jürgen Sengera's June 23 resignation as CEO of Westdeutsche Landesbank, which is 43.2% owned by the State of North Rhine-Westphalia, could spur far-reaching change among Germany's bloated public-sector banks. Sengera, who quit after Germany's financial watchdog criticized WestLB's risk-management procedures, wanted to transform the bank into a full-fledged commercial institution capable of competing on equal terms with private-sector counterparts. But his efforts ran into trouble when its London-based principal-finance unit, which takes stakes in companies and finances its investments by securitizing their revenue flows, made a series of hazardous deals that look likely to turn sour. Bankers say WestLB's blunder will put new pressure on the 11 *Landesbanken* to merge or be sold off.

TURKEY WANTS IN ON IRAQ

▶ After refusing to allow the U.S. military to use its bases to mount a northern front against Saddam Hussein's regime this spring, Turkey is opening its military bases, ports, and airports to the U.S. and other countries rebuilding Iraq. The move marks an effort by Ankara to ease tensions with Washington—and cash in on reconstruction. Turkey recently proposed to the Bush Administration projects ranging from setting up an Iraqi cell-phone network to building roads and dams, says Soner Cagaptay, a Turkey analyst at the Washington Institute fo Near East Policy. Ankara wants to fund the projects partly with up to $8.5 billion in loan guarantees previously offered by the U.S.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SLIMED: *Scannell pushes staff to inject more fun into shows*

TELEVISION

HOW TO TICKLE A CHILD

Nickelodeon keeps the hits—and the revenue—coming

Don't get Matthew Friedman started on Nickelodeon. "I want to be SpongeBob SquarePants!" the 8-year-old yelps while standing with his mom in the giant Toys 'R' Us in New York's Times Square. But it's not just the undersea-dwelling sponge. He loves it all: *Rugrats*, *The Wild Thornberrys*, even *U-Pick Live*, where kids get to choose what cartoons are aired. It's the station he turns to when there's nothing else on. Scratch that: For Matthew, there basical is nothing else on. "A long as there's Nic elodeon, I wouldn't care the rest of my TV brol down," he confides.

On an average da about half the kids in America who a watching TV are viewing right alo with Matthew. The 24-year-old cab network, a unit of Viacom Inc., has b come a $1.1 billion blockbuster machi with global hits ranging from *Blu Clues* and *Dora the Explorer* f preschoolers to *The Adventures of Jim my Neutron, Boy Genius*, and *The Fa ly OddParents* for an older crowd. has been the highest-rated basic cab network in the U.S. since 1995 and w 43% ahead of No.2 Fox News Chann through June 15 of this year, accordi to Nielsen Media Research Inc.

The brand is so potent, critics sa that even run-of-the-mill shows get go ratings simply because they appear the network. And while they may grum ble that execs can be dictatorial abo what appears, advertisers admit there often no better place to reach kids. Sa Nickelodeon chief Herb Scannell, wh was recently promoted to group pre dent of MTV Networks, which hous Nick, Comedy Central, VH1, and MT "You must buy Nick if you're building marketing plan." Even rival John Wilson, senior vice-president of pr gramming at Public Broadcasting Se vice, calls Nick terrific at "burning th brand into kids' psyches."

Nick continues to thrive at a tim when overall children's viewing is down and competitors are clawing for market share, but the kids' powerhouse can't afford to become complacent. There was a time, after all, when nobody could rival Walt Disney Co. for kids' hearts. Disney has long since stumbled, but its Disney Channel is popular with the 9-to-12 group known as 'tweens, and other rivals are roping in boys with more-violent action shows.

For now, though, nobody has a lock on the 2-to-11 market like Nickelodeon.

THE THR AGES OF NICK

On a typic day, about of the kids watching T are glued t Nickelodec programmi Here's how network sta up with ke groups cov by advertis

KID STUFF No other TV business comes close to Nick in spinning off its brands into merchandise, movies, and live shows

NICKELODEON

hat may be partly e to its obsession th research, which ludes about 300 fos groups a year to st shows and ferret t trends. Others edit its ability to ntrol content through its own animan studios and production facilities. In y case, Nick has become remarkably ept at answering a question that nags rketers and manufacturers worlde: What do kids want?

In the world of TV, at least, they em to want slightly edgy, funny sto- and characters that look at the rld from a kid's point of view. They ave cheekiness, adventure, and indendence without straying too far from me. They want to gross out their rents with burps, farts, and celebris like Jim Carrey covered in thick een slime. (Yet Nick quietly wins ult approval with a ban on violence d sexual themes.) They want a place t's cool enough to draw stars like ll Smith for its annual *Kids Choice ards* or celebs like Britney Spears the sketch comedy *All That*. Nick o proved that boys would watch ows starring girls, that Latino charers like Dora could appeal to a genal audience, and that homely characs like *The Wild Thornberrys*' Eliza ld be heroes.

But if Nick's goal isn't to cater to rents, it does have to please its own rent. While Viacom doesn't disclose unit's financials, analysts at research firm Kagan World Media estimate that Nick generated cash flow of $615 million last year, with margins of almost 57%, vs. a 33% average for the industry. Its ad rates are more than double those of peers like The Cartoon Network. "Nickelodeon is a very hot property—bigger than MTV," notes Tom Freston, chairman and CEO of Viacom's MTV Networks. Moreover, Nick has leveraged its cable success into everything from magazines to live shows to toys.

That gives Nick an added edge over cable networks that rely primarily on advertising and affiliates' fees. Another advantage: owning production facilities in Orlando and Hollywood, as well as animation studios in Burbank, Calif., and New York City. Not only does that keep programming expenses to less than two-thirds the industry average, it allows the network to take chances with less risk.

Take *SpongeBob*, a phenomenon that took even Nick execs by surprise. "I thought it was cute," says Freston. "But no one was banging on the table, saying, 'This will be a runaway hit.'" Instead, the wacky series created by Steve Hillenberg started out four years ago in a weekend slot, soon becoming a Saturday morning and weekday prime-time hit. Ditto for *The Fairly OddParents*, which creator Butch Hartman tested as a series of short cartoons two years ago. He calls Nick's Burbank animation studio "a big day care for adults," with Scannell acting as proud parent.

Despite his low-key style and penchant for self-deprecating jokes, Scannell is a key force behind the Nickelodeon brand. *Dora the Explorer* was initially a bunny until Scannell, himself part Puerto Rican, pushed for more Hispanic characters. It was he who, early in his tenure, went to Viacom's tightfisted Chief Executive Sumner M. Redstone with a request for $350 million to build his own animation studio. "I thought that's what you did when you're president—ask for a lot of money," shrugs Scannell, 46. Insiders say the Nickelodeon veteran and father of two girls is a driven leader who's constantly pushing staffers to take more risks, be more relevant, inject more fun.

That doesn't mean Nick always gets it right. *Animorphs*, which sprang from a Scholastic Corp. book series, and *Noah Knows Best* both fell flat. General Manager Cyna Zarghami admits they were

HOOLERS

he Explorer, with nic heroine who has over into broad nce, rules among e 2 to 5. Still popular *s Clues*.

ELEMENTARY-SCHOOLERS

Rugrats put Nick on the map among viewers age 6 to 11; now *SpongeBob SquarePants* and *Fairly OddParents* own that group.

'TWEENS

Nick is reaching kids age 9 to 12 with ***All That***, *Brothers Garcia*, and the annual celebrity-infused *Kids Choice Awards*.

"too talky and a little too old." Then there are the oddball bets like *CatDog*, a show about—you got it—a dog and a cat trapped in the same body. While it posted decent numbers on TV, it was a bomb on the merchandising front. Nick execs sheepishly suggest the concept didn't translate well to products.

Despite all the talk about not developing shows with merchandise in mind, in fact, no other TV-based business has been as aggressive in spinning off its brands into merchandise, movies, and live events. Nickelodeon Enterprises is the fastest-growing part of the business and could give Nick close to $200 million this year. Jeffrey D. Dunn, who heads up the operation, proudly points out that hits like *Blue's Clues*, *Dora*, and *SpongeBob* are home-run licensed properties that helped generate $2.6 billion in retail sales last year. Now he's evaluating proposals for everything from preloaded debit cards to a Nickelodeon hotel chain targeted at families with young kids.

Still, Nickelodeon faces plenty of risks, from a notoriously fickle audience to overextending its brand. Advertisers argue that Nick has made more than a few enemies with its high-handed style. They complain that execs don't let advertisers buy spots on hit programs like *SpongeBob*, for example, instead forcing them to b a rotating time slot wh their ads can be mov around at will. (Nick sponds that it alw guarantees certain ratings delive Nick also tends to veto more ads t rivals and is less willing to work w advertisers to play up their bran "They treat us like we're evil stead of their partner," mutt one consumer-products executi Freston counters that it wo be worse to tarnish a preci asset: "Once you're seen as s ing your soul, it's very hard recover from that."

Nobody needs to tell that Nick's most important c stituency. Just ask 9-year- Taylor Guthrie of Lonsdale, A At the end of a long day school, he clicks on to Nick. love all of the shows," bea Taylor, noting that his 6-year- sister and 11-year-old brother watch too. "It makes me happy." While adv tisers and rivals may grumble, that k of loyalty is hard to ignore.

By Diane Brady and Gerry Kh mouch in New York, with bureau repo

SPONGEBOB: *Initially, no one expected a huge hit*

NICKELODEON'S THREE-LEGGED STOOL

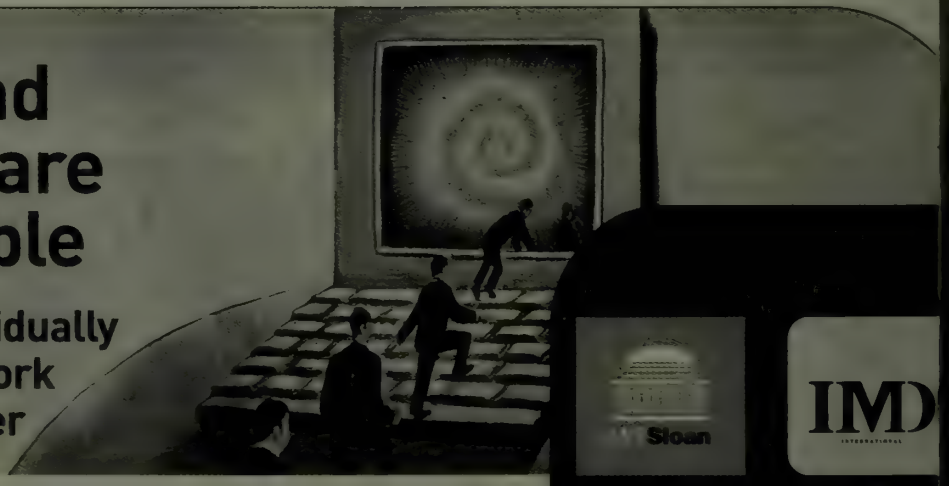
With three separate revenue streams, the children's programmer has a hedge against periods when, say, advertising is sluggish.

ADVERTISING	LICENSING AND MERCHANDISING	FEES FROM TV AFFILIATES
$605 MILLION	$165 MILLION	$330 MILLION

Data: 2002 revenues based on *BW* estimates

Technology and management are now inseparable

You can study them individually but, today, neither can work properly without the other



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Your guide to our advertisers' upcoming events, products, and services.

P&G

How **A.G. LAFLEY** is revolutionizing a bastion of corporate conservatism

BY ROBERT BERNER

Cover Story

It's Mother's Day, and Alan G. "A.G." Lafley, chief executive of Procter & Gamble Co., is meeting with the person he shares time with every Sunday evening—Richard L. Antoine, the company's head of human resources. Lafley doesn't invite the chief financial officer of the $43 billion business, nor does he ask the executive in charge of marketing at the world's largest consumer-products company. He doesn't invite friends over to watch *The Sopranos*, either. No, on most Sunday nights it's just Lafley, Antoine, and stacks of reports on the performance of the company's 200 most senior executives. This is the boss's signature gesture. It shows his determination to nurture talent and serves notice that little escapes his attention. If you worked for P&G, you would have to be both impressed and slightly intimidated by that kind of diligence.

On this May evening, the two executives sit at the dining-room table in Antoine's Cincinnati home hashing over the work of a manager who distinguished himself on one major assignment but hasn't

NIGEL DICKSON

Cover Story

LAFLEY'S VISION

Here's how the CEO is reinventing P&G

quite lived up to that since. "We need to get him in a position where we can stretch him," Lafley says. Then he rises from his chair and stands next to Antoine to peer more closely at a spreadsheet detailing P&G's seven management layers. Lafley points to one group while tapping an empty water bottle against his leg. "It's not being felt strongly enough in the middle of the company," he says in his slightly high-pitched voice. "They don't feel the hot breath of the consumer."

If they don't feel it yet, they will. Lafley, who took over when Durk I. Jager was pressured to resign in June, 2000, is in the midst of engineering a remarkable turnaround. The first thing Lafley told his managers when he took the job was just what they wanted to hear: Focus on what you do well—selling the company's major brands such as Tide, Pampers, and Crest—instead of trying to develop the next big thing.

Now, those old reliable products have gained so much market share that they are again the envy of the industry. So is the company's stock price, which has climbed 58%, to $92 a share, since Lafley started, while the Standard & Poor's 500-stock index has declined 32%. Banc of America analyst William H. Steele forecasts that P&G's profits for its current fiscal year, which ended June 30, will rise by 13%, to $5.57 billion, on an 8% increase in sales, to $43.23 billion. That exceeds most rivals'. Volume growth has averaged 7% over the past six quarters, excluding acquisitions, well above Lafley's goal and the industry average.

The conventional thinking is that the soft-spoken Lafley was exactly the antidote P&G needed after Jager. After all, Jager had charged into office determined to rip apart P&G's insular culture and remake it from the bottom up. Instead of pushing P&G to excel, however, the torrent of proclamations and initiatives during Jager's 17-month reign nearly brought the venerable company to a grinding halt.

Enter Lafley. A 23-year P&G veteran, he wasn't supposed to bring fundamental change; he was asked simply to restore the company's equilibrium. In fact, he came in warning that Jager had tried to implement too many changes too quickly (which Jager readily admits now). Since then, the mild-mannered 56-year-old chief executive has worked to revive both urgency and hope: urgency because, in the previous 15 years, P&G had developed exactly one successful new brand, the Swiffer dust mop; and hope because, after Jager, employees needed reassurance that the old ways still had value. Clearly, Lafley has undone the damage at P&G.

What's less obvious is that, in his quiet way, Lafley has proved to be even more of a revolutionary than the flamboyant Jager. Lafley is leading the most sweeping transformation of the company since it was founded by William Procter and James Gamble in 1837 as a maker of soap and candles. Long before he became CEO, Lafley had been pondering how to make P&G relevant in the 21st century, when speed and agility would matter more than heft. As president of North American operations, he even spoke with Jager about the need to remake the company.

So how has Lafley succeeded where Jager so spectacularly failed? In a word, style. Where Jager was gruff, Lafley is soothing. Where Jager bullied, Lafley persuades. He listens more than he talks. He is living proof that the messenger is just as important as the message. As he says, "I'm not a screamer, not a yeller. But don't get confused by my style. I am very decisive." Or as Robert A. McDonald, president of

P&G

TURNING THE TIDE

FABRIC AND HOME CARE

Lafley has aggressively cut costs in the company's largest division. But Tide in particular faces intense competition from lower-priced rivals. To compensate, Lafley is introducing high-margin products, such as the Swiffer Duster.

SALES*	29%
OPERATING PROFIT MARGIN	25%
OUTLOOK	VERY GOOD

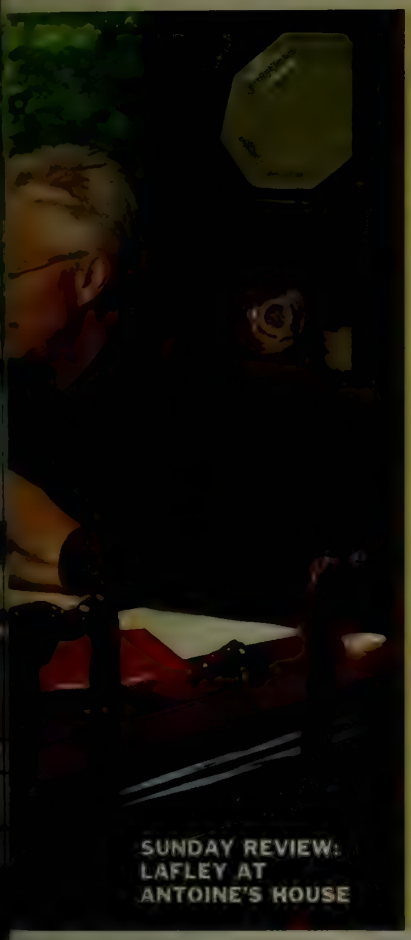
BEAUTY CARE

Lafley has quickly expanded this business by acquiring Clairol and Wella. But the company has less expertise here and still has to prove it can grow internally.

SALES	28
OPERATING PROFIT MARGIN	23
OUTLOOK	

*Share of total sales. Estimates for fiscal year ending June 30, 2003

Data: Banc America Securities


SUNDAY REVIEW: LAFLEY AT ANTOINE'S HOUSE

OUTSOURCING If it's not a core function, the new P&G won't do it. Info tech and bar-soap manufacturing have already been contracted out. Other jobs will follow.

ACQUISITIONS Not everything has to be invented in company labs. Lafley wants half of all new-product ideas to come from the outside.

BUILDING STAFF Managers are under much closer scrutiny, as Lafley scans the ranks for the best and the brightest and singles them out for development.

BRAND EXPANSION The Crest line now includes an electric toothbrush and tooth-whitening products along with toothpaste. Lafley is making similar moves elsewhere.

PRICING P&G isn't just the premium-priced brand. It will go to the lower end if that's where opportunity lies.

P&G's global fabric and home-care division, says, "people want to follow him. I frankly love him like my brother."

Indeed, Lafley's charm offensive has so disarmed most P&Gers that he has been able to change the company profoundly. He is responsible for P&G's largest acquisitions ever, buying Clairol in 2001 for $5 billion and agreeing to purchase Germany's Wella in March for a price that now reaches $7 billion. He has replaced more than half of the company's top 30 officers, more than any P&G boss in memory, and cut 9,600 jobs. And he has moved more women into senior positions. Lafley skipped over 78 general managers with more seniority to name 42-year-old Deborah A. Henretta to head P&G's then-troubled North American baby-care division. "The speed at which A.G. has gotten results is five years ahead of the time I expected," says Scott Cook, founder of software maker Intuit Inc., who joined P&G's board shortly after Lafley's appointment.

Still, the Lafley revolution is far from over. Precisely because of his achievements, Lafley is now under enormous pressure to return P&G to what it considers its rightful place in Corporate America: a company that is admired, imitated, and uncommonly profitable. Nowhere are those expectations more apparent than on the second floor of headquarters, where three former chief executives still keep offices. John Pepper, a popular former boss who returned briefly as chairman when Jager left but gave up the post to Lafley last year, leans forward in his chair as he says: "It's now clear to me that A.G. is going to be one of the great CEOs in this company's history."

But here's the rub: What Lafley envisions may be far more radical than what Pepper has in mind. Consider a confidential memo that circulated among P&G's top brass in late 2001 and angered Pepper for its audacity. It argued that P&G could be cut to 25,000 employees, a quarter of its current size. Acknowledging the memo, Lafley admits: "It terrified our organization."

Lafley didn't write the infamous memo, but he may as well have. It reflects the central tenet of his vision—that P&G should do only what it does best, nothing more. Lafley wants a more outwardly focused, flexible company. That has implications for every facet of the business, from manufacturing to innovation. For example, in April he turned over all bar-soap manufacturing, including Ivory, P&G's oldest surviving brand, to a Canadian contractor. In May, he outsourced P&G's information-technology operation to Hewlett-Packard Co.

No bastion has been more challenged than P&G's research and development operations. Lafley has confronted head-on the stubbornly held notion that everything must be invented within P&G, asserting that half of its new products should come from the outside. (P&G now gets about 20% of its ideas externally—up from about 10% when he took over.) "He's absolutely breaking

Y AND IILY CARE

now vies with Kimberly- to dominate the sable-diaper market. But etition has pushed prices which is why this division has the slowest profit-margin growth.

	23%
ATING T MARGIN	17%
OOK	GOOD

HEALTH CARE

With its SpinBrush and tooth-whitening products, P&G has regained the lead in oral care from Colgate. The division will get a lift from distributing heartburn drug Prilosec over the counter. But the pharmaceutical business depends on one big seller, Actonel for osteoporosis.

SALES	13%
OPERATING PROFIT MARGIN	18%
OUTLOOK	MIXED

SNACKS AND BEVERAGES

Because the division generates the company's lowest profit margins, many expect Lafley to continue to extricate P&G from these businesses. He has already sold Crisco and Jiff to J.M. Smuckers.

SALES	7%
OPERATING PROFIT MARGIN	15%
OUTLOOK	WEAK

You are accountable.

To your shareholders.

And your board,
and your employees,
and your customers.

Who is accountable to you?
Who could be?

Who could bring together
enough talent
to handle a major initiative?

The whole thing
start to finish?

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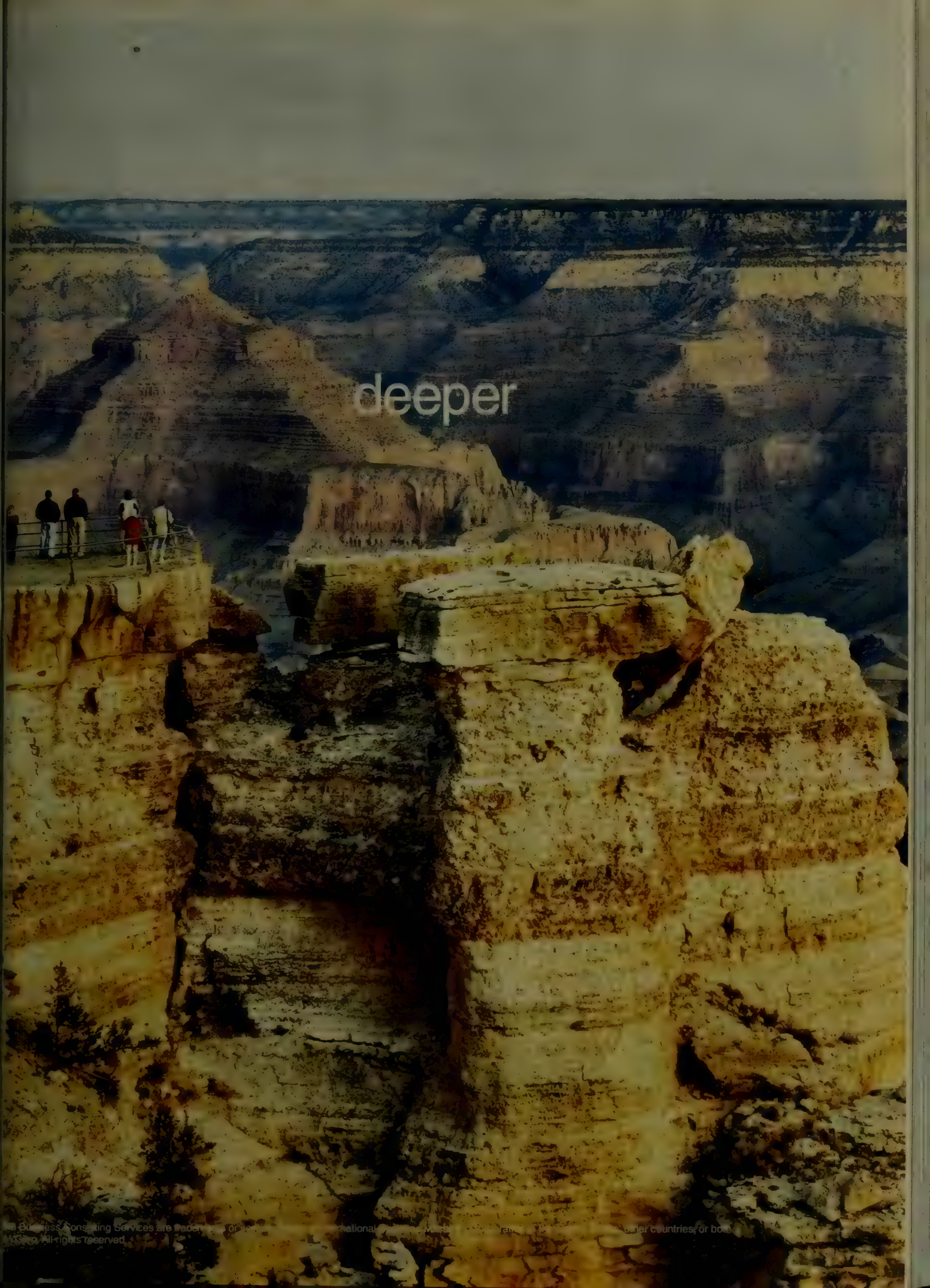

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many well-set molds at P&G," says eBay Inc.'s CEO, Margaret C. "Meg" Whitman, whom Lafley appointed to the board.

Lafley's quest to remake P&G could still come to grief. As any scientist will attest, buying innovation is tricky. Picking the winners from other labs is notoriously difficult and often expensive. And P&G will remain uncomfortably reliant on Wal-Mart Stores Inc., which accounts for nearly a fifth of its sales. Lafley is looking to pharmaceuticals and beauty care for growth, where the margins are high but where P&G has considerably less experience than rivals.

The biggest risk, though, is that Lafley will lose the P&Gers themselves. Theirs is a culture famously resistant to new ideas. To call the company insular may not do it justice. Employees aren't kidding when they say they're a family. They often start out there and grow up together at P&G, which only promotes from within. Cincinnati itself is a small town: Employees live near one another, they go to the same health clubs and restaurants. They are today's company men and women—and proud of it.

Lafley is well aware of his predicament. On a June evening, as he sits on the patio behind his home, he muses about just that. The house, which resembles a Tuscan villa and overlooks the Ohio River and downtown Cincinnati, is infused with P&G history. Lafley bought it from former CEO John G. Smale three years before he was named chief executive. A black-and-gold stray cat the family feeds sits a few feet away and watches Lafley as he sips a Beck's beer. The clouds threaten rain. "I am worried that I will ask the organization to change ahead of its understanding, capability, and commitment," Lafley admits.

Cover Story

For most of its 166 years, P&G was one of America's preeminent companies. Its brands are icons: It launched Tide in 1946 and Pampers, the first disposable diaper, in 1961. Its marketing was innovative: In the 1880s, P&G was one of the first companies to advertise nationally. Fifty years later, P&G invented the soap opera by sponsoring the *Ma Perkins* radio show and, later, *Guiding Light.*

Its management techniques, meanwhile, became the gold standard: In the 1930s, P&G developed the idea of brand management—setting up marketing teams for each brand and urging them to compete against each other. P&G has long been the business world's finest training ground. General Electric Co.'s Jeffrey R. Immelt and 3M's W. James McNerney Jr. both started out on Ivory. Meg Whitman and Steven M. Case were in toilet goods, while Steve Ballmer was an assistant product manager for Duncan H cake mix, among other goods. They, of course, went on to eBay, AOL Time Warner, and Microsoft.

But by the 1990s, P&G was in danger of becoming ano Eastman Kodak Co. or Xerox Corp., a once-great company had lost its way. Sales on most of its 18 top brands w slowing; the company was being outhustled by more focuse vals such as Kimberly-Clark Corp. and Colgate-Palmolive The only way P&G kept profits growing was by cutting co hardly a strategy for the long term. At the same time, the namics of the industry were changing as power shifted fi manufacturers to massive retailers. Through all of this, muc senior management was in denial. "Nobody wanted to about it," Lafley says. "Without a doubt, Durk and I and a others were in the camp of 'We need a much bigger chang

When Jager took over in January, 1999, he was hell-bent providing just that—with disastrous results. He introdu expensive new products that never caught on while letting

P&G

TRIAL & ERROR

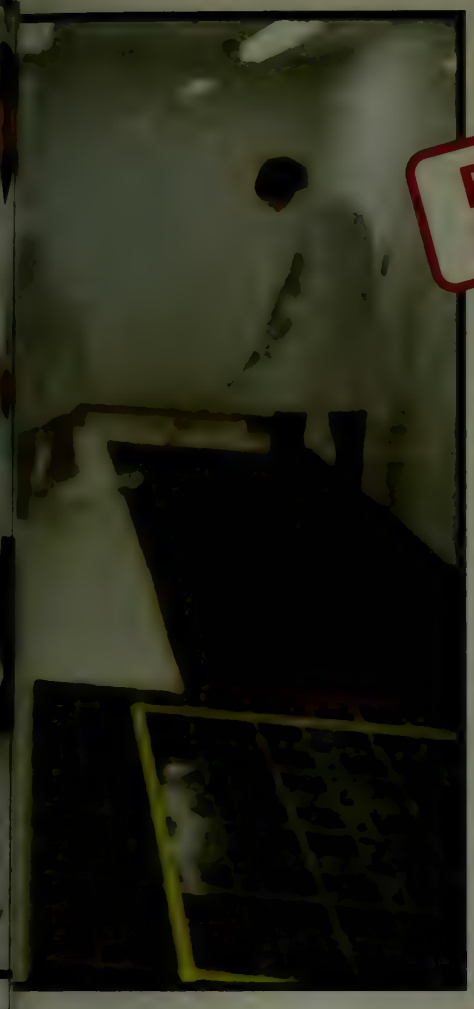
While the company invents most of its products in its own labs, Lafley wants half of all new ideas to come from the outside

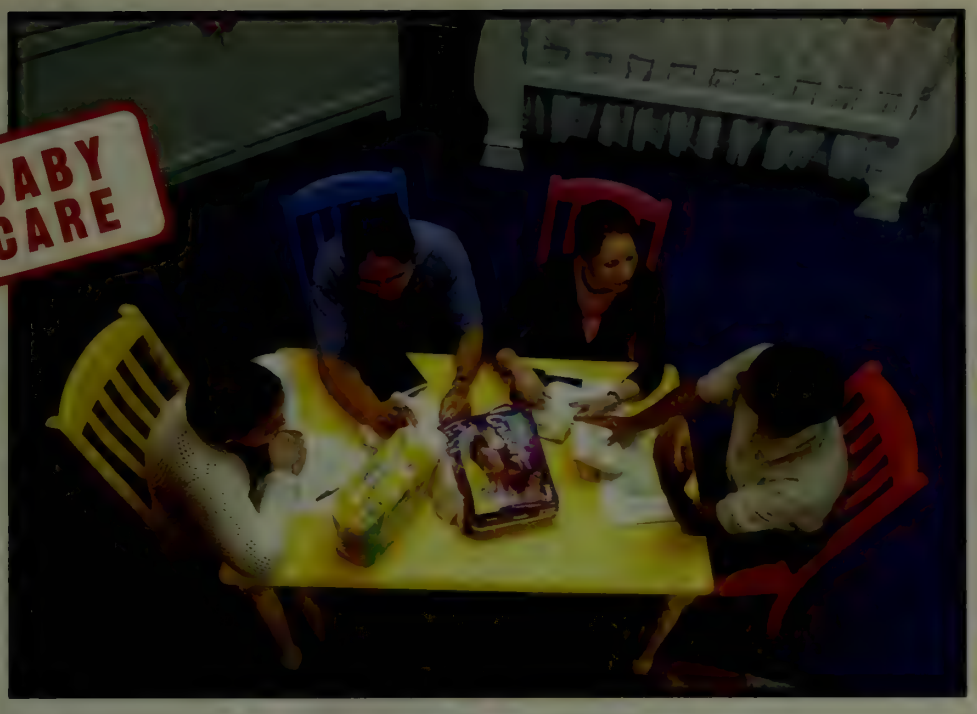
P&G'S FAMILY TREE

The CEOs who preceded Lafley launched ambitious projects but also oversaw a gradual erosion of P&G's core brands

1981-90 John Smale moves P&G into the health-care and beauty business, which becomes central to the company. His decision to expand its food and beverage division doesn't amount to nearly as much.

1990-9 Edwin helps b P&G to world, cosmet P&G, t the pur of Max Factor and Co But sales of major br slow—as internationa expansion and new-p launches take preced





ing brands drift. He wanted buy two huge pharmaceuti- companies, a plan that reatened P&G's identity but ver was carried out. And he t in place a companywide re- ganization that left many em- yees perplexed and preoccupied. Soaring commodity prices, favorable currency trends, and a tech-crazed stock market ln't help either. At a company prized for consistent earn- gs, Jager missed forecasts twice in six months. In his first d last full fiscal year, earnings per share rose by just 3.5% stead of an estimated 13%. And during that time, the share ice slid 52%, cutting P&G's total market capitalization by $85 llion. Employees and retirees hold about 20% of the stock. he family began to turn against its leader.

But Jager's greatest failing was his scorn for the family. ger, a Dutchman who had joined P&G overseas and worked s way to corporate headquarters, pitted himself against the P&G culture, contending that it was burdensome and insufferable, says Susan E. Arnold, president of P&G's beauty and feminine care division. Some go-ahead employees even wore buttons that read "Old World/New World" to express disdain for P&G's past. "I never wore one," Arnold sneers. "'The old Procter is bad, and the new world is good.' That didn't work."

On June 6, 2000, his 30th wedding anniversary, Lafley was in San Francisco when he received a call from Pepper, then a board member: Would he become CEO? Back in Cincinnati, a boardroom coup unprecedented in P&G's history had taken place.

As Lafley steps into the small study in his house three years later, a Japanese drawing on the wall reminds him of what it was like to become CEO. The room, with its painting of a samurai warrior and red elephant-motif wallpaper, alludes to his stint running P&G's Asian operations. Bookshelves hold leather-bound volumes of Joseph Conrad and Mark Twain. A simple wooden desk faces the window. Lafley focuses on the drawing, which depicts a man caught in a spider's web; it was given to him by the elder of his two sons, Patrick. "In the first few days, you are just trying to figure out what kind of web it is," he says.

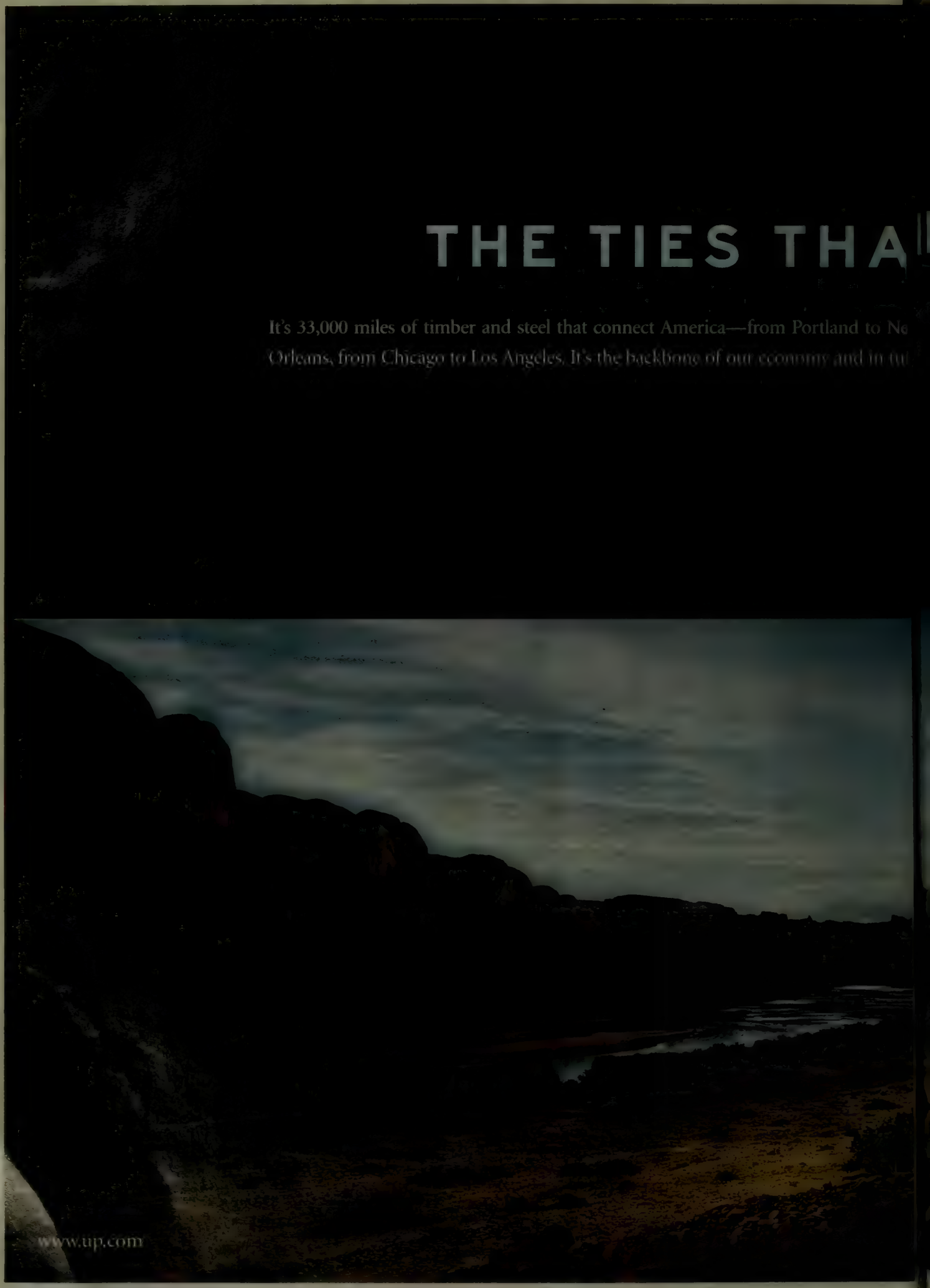
In a sense, Lafley had been preparing for this job his entire adult life. He never hid the fact that he wanted to run P&G one day. Or if not the company, then a company. That itself is unusual since, like almost all P&Gers, Lafley has never worked anywhere else. After graduating from Hamilton College in 1969, Lafley decided to pursue a doctorate in medieval and Renaissance history at the University of Virginia. But he dropped out in his first year to join the Navy (and avoid being drafted into the Army). He served in Japan, where he got his first experience as a merchandiser, supplying Navy retail stores. When his tour of duty ended in 1975, he enrolled in the MBA program at Harvard Business School. And from there, he went directly to Cincinnati.

When he was hired as a brand assistant for Joy dish detergent in 1977 at age 29, he was older than most of his colleagues and he worried that his late start might hinder his rise at P&G. Twice within a year in the early 1980s, Lafley quit. "Each time, I talked him back in only after drinking vast

1995-99
John Pepper pushes into developing markets such as China and Russia and starts to the company's tional structure. But emain weak, and of P&G's profit gains rom cost-cutting.

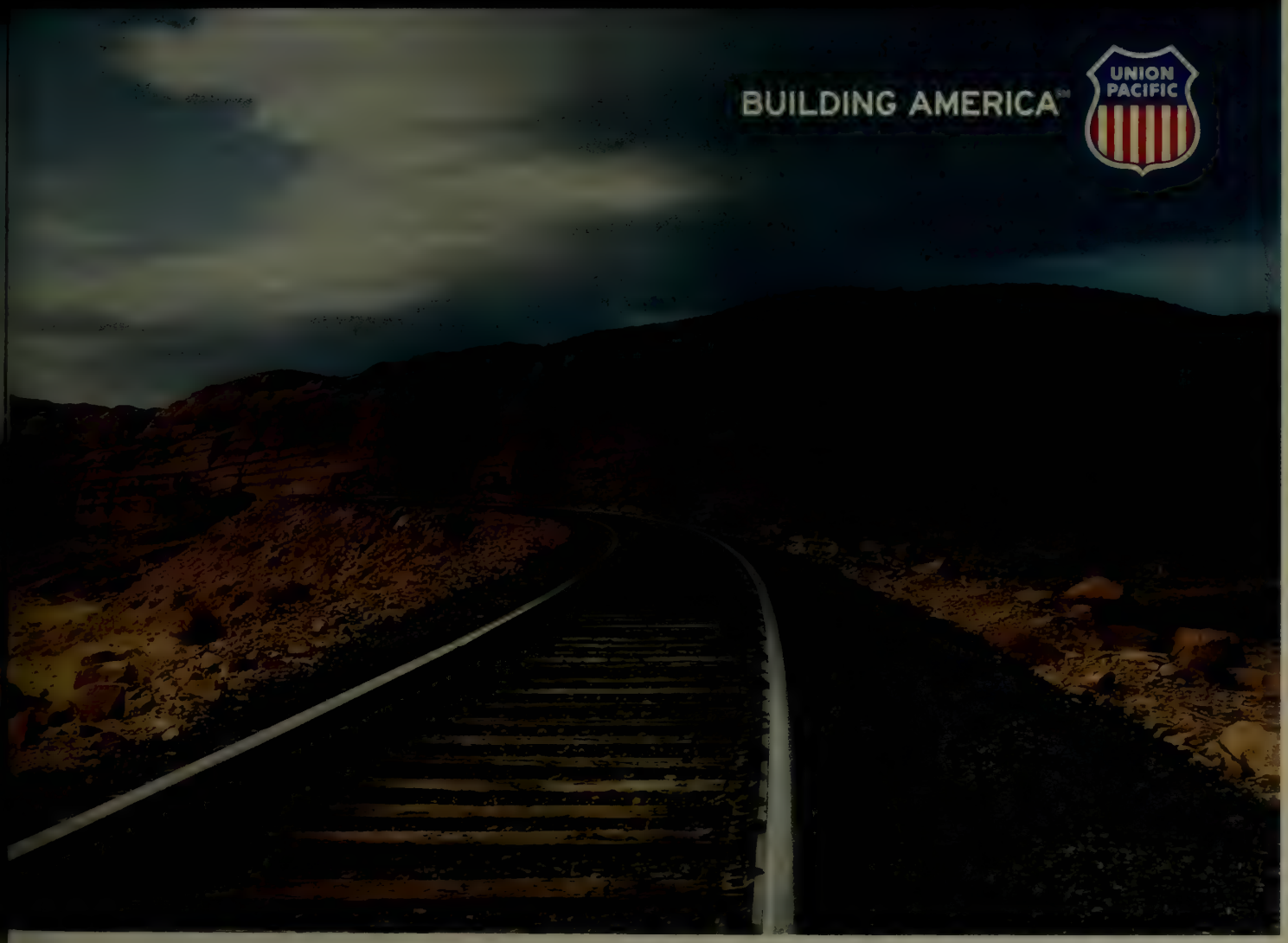
1999-2000
Durk Jager tries to jump-start innovation by launching expensive new products, which flop, and by trying to shake up P&G's stodgy culture, which quickly demoralizes many employees.

(CLOCKWISE FROM TOP) PHOTOGRAPHS BY SCOTT GOLDSMITH (3), PR NEWSWIRE PHOTO SERVICE, SIGELMAN/BLOOMBERG NEWS, COURTESY OF PROCTER AND GAMBLE (2)


THE TIES THA
It's 33,000 miles of timber and steel that connect America—from Portland to Ne
Orleans, from Chicago to Los Angeles. It's the backbone of our economy and in tu
www.up.com

IND A NATION.

backbone of our nation. Most importantly, it's 47,000 men and women who every
transport the raw materials and finished goods that keep our country moving.



amounts of Drambuie," says Thomas A. Moore, his boss at the time, who now runs biotech company Biopure Corp. On the second occasion, then-CEO John Smale met with Lafley, who had accepted a job as a consultant in Connecticut. Without making any promises, Smale says he told Lafley that "we thought there was no limit on where he was going to go."

Sure enough, Lafley climbed quickly to head P&G's soap and detergent business, where he introduced Liquid Tide in 1984. A decade later, he was promoted to head the Asian division. Lafley returned from Kobe, Japan, to Cincinnati in 1998 to run the company's entire North American operations. To ease the transition home, he and his younger son, Alex, who was then 12, studied guitar together. Two years later, Lafley was named CEO.

Along the way, he developed a reputation as a boss who stepped back to give his staff plenty of responsibility and helped shape decisions by asking a series of keen questions—a process he calls "peeling the onion." And he retained a certain humility. He still collects baseball cards, comic books, and rock 'n' roll 45s. Whereas some executives might have a garage full of antique cars or Harley-Davidsons; Lafley keeps two Vespa motor scooters. "People wanted him to succeed," says Virginia Lee, a former P&Ger who worked for Lafley at headquarters and overseas.

As CEO, Lafley hasn't made grand pronouncements on the future of P&G. Instead, he has spent an inordinate amount of time patiently communicating how he wants P&G to change. In a company famed for requiring employees to describe every new course of action in a one-page memo, Lafley's preferred approach is the slogan. For example, he felt that P&G was letting technology rather than consumer needs dictate new products. Ergo: "The consumer is boss." P&G wasn't working closely enough with retailers, the place where consumers first see the product on the shelf: "The first moment of truth." P&G wasn't concerned enough with the consumer's experience at home: "The second moment of truth."

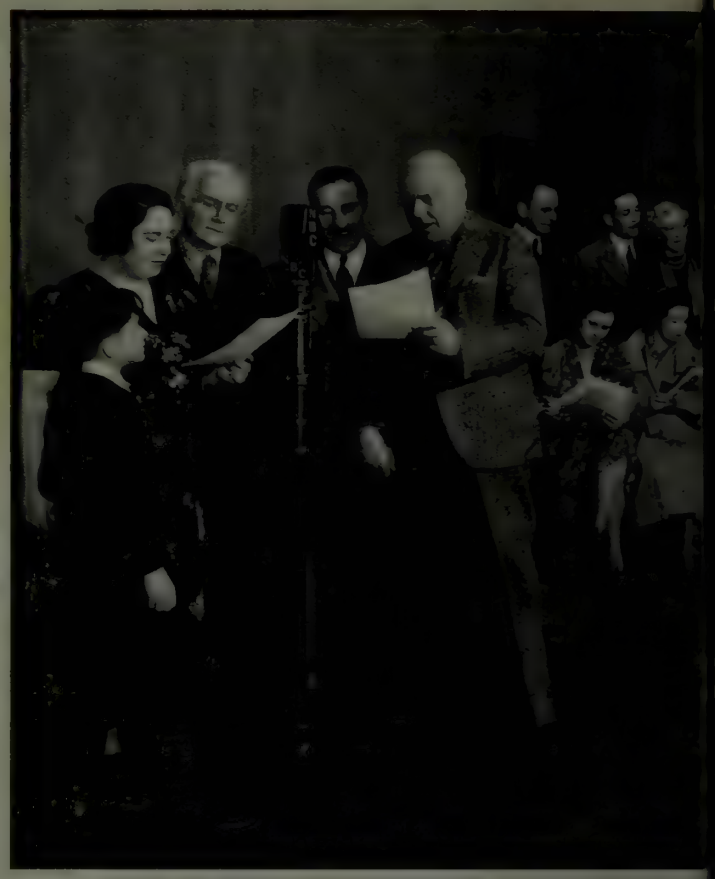
Lafley uses these phrases constantly, and they are echoed throughout the organization. At the end of a three-day leadership seminar, 30 young marketing managers from around the world present what they have learned to Lafley. First on the list: "We are the voice of the consumer within P&G, and they are the heart of all we do." Lafley, dressed in a suit, sits on a stool in front of the group and beams. "I love the first one," he laughs as the room erupts in applause.

When he talks about his choice of words later, Lafley is a tad self-conscious. "It's *Sesame Street* language—I admit that," he says. "A lot of what we have done is make things simple because the difficulty is making sure everybody knows what the goal is and how to get there."

P&G

FAMOUS FIRSTS

No company has done more to develop the art of marketing



Lafley has also mastered the art of the symbolic gestur The 11th floor at corporate headquarters had been the r doubt of senior executives since the 1950s. Lafley did awa with it, moving all five division presidents to the same floo as their staff. Then he turned some of the space into a lea ership training center. On the rest of the floor, he knocke down the walls so that the remaining executives, includir himself, share open offices. Lafley sits next to the two peop he talks to the most, which, in true P&G style, was official established by a flow study: HR head Antoine and Vice-Chai man Bruce Byrnes. As if the Sunday night meetings with A toine weren't proof enough of Lafley's determination to mak sure the best people rise to the top. And Byrnes, who Lafley refers to as "Yoda"—the sage-like *Star Wars* chara ter—gets a lot of face time because of his marketing e pertise. As Lafley says, "the assets at P&G are what? Our pe ple and our brands."

Just as emblematic of the Lafley era is the floor's new co ference room, where he and P&G's 12 other top executive meet every Monday at 8 a.m. to review results, plan strat

BORN Keene, N.H., on June 13, 1947; the "A" stands for Alan and "G" for George. Father was human resources manager at GE and Chase Manhattan Bank; mother raised Lafley and his three sisters.

FAMILY ROOTS French Canadian; two LaFleur brothers moved to New Hampshire in mid-19th century and changed name to Lafley.

CURRENT POSITION of Procter & Gamble si 2000, chairman since

EDUCATION AB in his Hamilton College, 196 spent junior year at the Sorbonne; MBA, Harva Business School, 1977

MILITARY EXPERIEN Served in the Navy as supply officer in Japan for five years during th Vietnam War.

33

invents
oap opera, a perfect
mer-sales vehicle

1931

Promotion department manager and future CEO Neil McElroy creates modern theory of **brand management**

1960

P&G wins **American Dental Assn.** approval of Crest as an effective cavity fighter

1961

The company launches Pampers, **the first disposable diaper**

1986

Pert Plus, **the first shampoo-conditioner combination**, is unveiled

, and set the drumbeat for the week. The table used to be ctangular; now it's round. The execs used to sit where ey were told; now they sit where they like. At one of ose meetings, an outsider might have trouble distinguishing e CEO: He occasionally joins in the discussion, but most of e time the executives talk as much to each other as to afley. "I am more like a coach," Lafley says afterward. "I am ways looking for different combinations that will get better sults." Jeff Immelt, who asked Lafley to join GE's board in 02, describes him as "an excellent listener. He's a sponge." And now, Lafley is carefully using this information to re-ape the company's approach to just about everything it es. When Lafley describes the P&G of the future, he says: We're in the business of creating and building brands." No-e, as P&Gers certainly have, that he makes no mention of anufacturing. While Lafley shies away from saying just how uch of the company's factory and back-office operations he ay hand over to someone else, he does admit that facing up the realities of the marketplace "won't always be fun." Of &G's 102,000 employees, nearly one-half work in its plants. So r, "Lafley has deftly handled the outsourcing deals, which has ssened fear within P&G," says Roger Martin, a close adviser of Lafley's who is dean of the University of Toronto's Joseph L. Rotman School of Management. All 2,000 of the information-technology workers were moved over to HP. At the bar-soap operations, based entirely in Cincinnati, 200 of the 250 employees went to work for the Canadian contractor.

Lafley's approach to selling P&G products is unprecedented at the company, too: He argues that P&G doesn't have to produce just premium-priced goods. So now there's a cheaper formulation for Crest in China. The Clairol deal gave P&G bargain shampoos such as Daily Defense. And with Lafley's encouragement, managers have looked at their most expensive products to make sure they aren't too costly. In many cases, they've actually lowered the prices.

And Lafley is pushing P&G to approach its brands more creatively. Crest, for example, isn't just about toothpaste anymore: There's also an electric toothbrush, SpinBrush, which P&G acquired in January, 2001. P&G is also willing to license its own technologies to get them to the marketplace faster. It joined with Clorox Co., maker of Glad Bags, last October to share a food-wrap technology it had developed. It was unprecedented for P&G to work with a competitor, says licensing head Jeffrey Weedman. The overall effect is undeniable. "Lafley has made P&G far more flexible," says Banc of America's Steele.

But Lafley still faces daunting challenges. Keeping up the earnings growth, for example, will get tougher as competitors fight back and as P&G winds down a large restructuring program—started under Jager but accelerated under Lafley. Furthermore, some of the gains in profit have resulted from cuts in capital and R&D spending, which Lafley has pared back to the levels of the company's rivals. And already, P&G has missed a big opportunity: It passed up the chance to buy water-soluble strips that contain mouthwash. Now, Listerine is making a bundle on the product.

Cover Story

Nor are all investors comfortable with growth through acquisitions. The deals make it harder for investors to decipher earnings growth from existing operations. Then there's the risk of fumbling the integration, notes Arthur B. Cecil, an analyst at T. Rowe Price Group Inc., which holds 1.74 million P&G shares. "I would prefer they not make acquisitions," he says. Already, Clairol hair color, the most important product in P&G's recent purchase, has lost five points of market share to L'Oréal in the U.S., according to ACNeilsen Corp.

Making deals, however, could be the only way to balance P&G's growing reliance on Wal-Mart. Former and current P&G employees say the discounter could account for one-third of P&G's global sales by the end of the decade. Meanwhile, the pressure from consumers and competitors to keep prices low will only increase. "P&G has improved its ability to take on those challenges, but those challenges are still there," says Lehman analyst Ann Gillin.

Still, Lafley may be uniquely suited to creating a new and improved P&G. Even Jager agrees that Lafley was just what the company needed. "He has calmed down the confusion that happened while I was there," says the former CEO. Jager left a letter on Lafley's desk the day he resigned telling his successor not to feel responsible for his fall. "You earned it," he recalls writing. "Don't start out with guilt."

Lafley says he learned from Jager's biggest mistake. "I avoided saying P&G people were bad," he says. "I enrolled them in change." Lafley, a company man through and through, just can't resist trying out a new slogan. ■

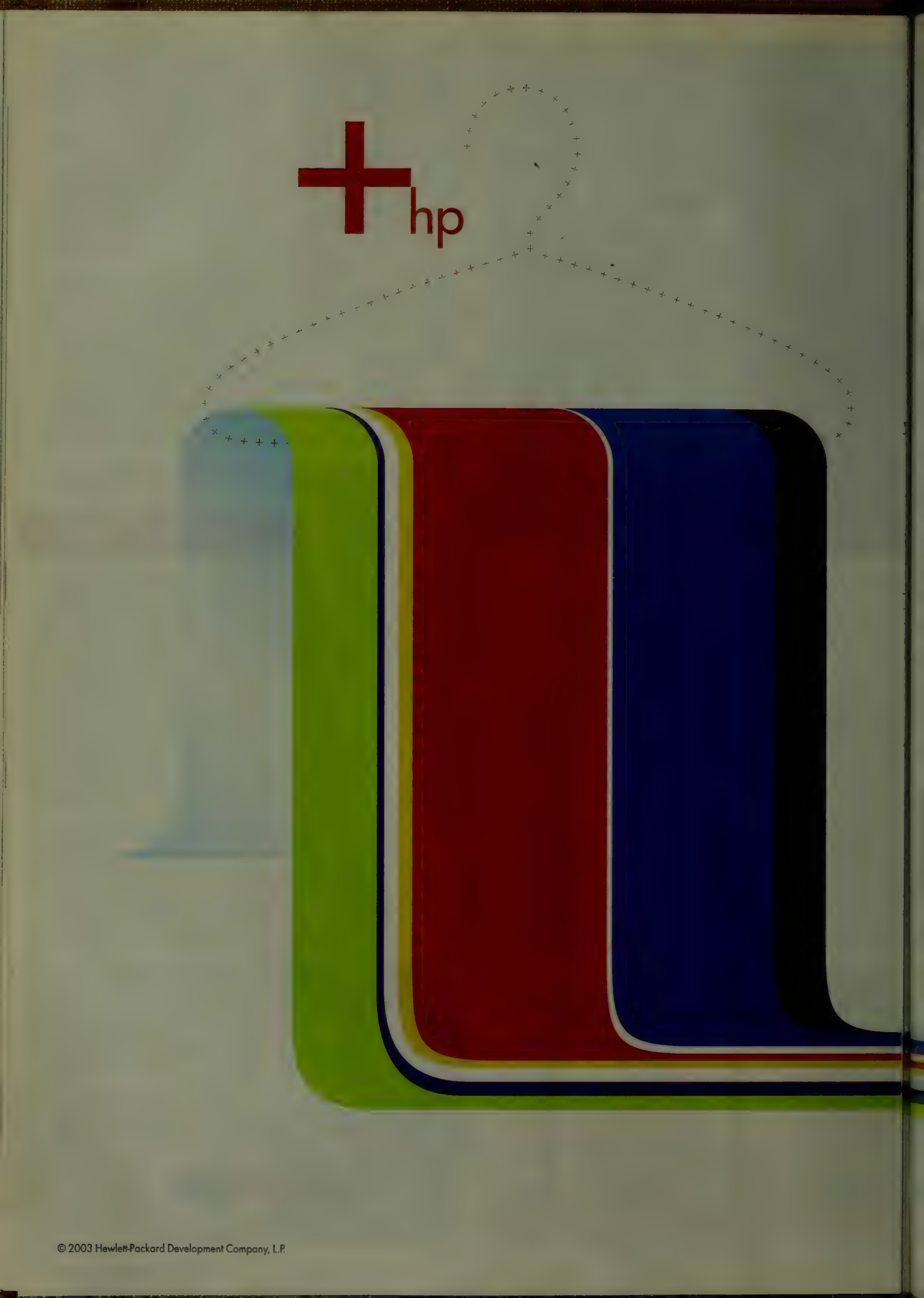
ER PATH Joined
s assistant brand
er for Joy dish-washing
1977. Worked his
the ranks, including
-year stint in Asia
the region's financial
Promoted from
f North American
ons to CEO three
go when his
essor, Durk Jager,
rced to resign.

AFTER HOURS Owns two Vespa scooters that he drives around his neighborhood. Has collected baseball cards since the 1950s.

FAMILY Married to wife, Margaret, for 33 years; they met at the University of Virginia; two sons, Patrick, 31, and Alex, 16. Family has a Cavalier King Charles Spaniel, two indoor cats, and two strays they feed.

BusinessWeek online

For an interview with A.G. Lafley, go to www.businessweek.com/magazine/extra.htm



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If you want your business documents to attract the attention they deserve, try printing them in color with an HP Business Inkjet 2600 printer. Whether you're printing a background heading in red or highlighting your positive earnings in green, color makes a powerful statement that cannot be ignored.

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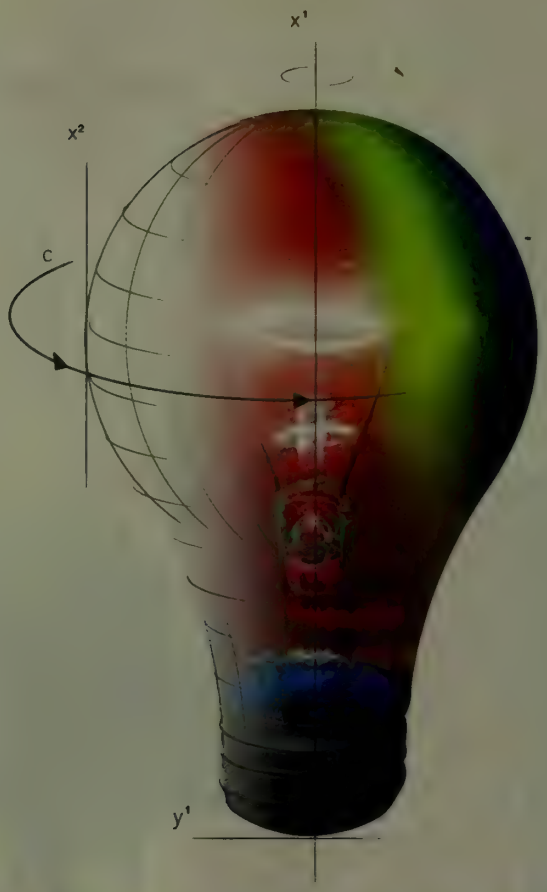


THE ROOTS OF INSPIRATION

. . . ARE AS VARIED AS THE VAST NUMBER OF PROFESSIONAL PRODUCT DESIGNERS OUT THERE. Sponsored by HP

Yet, a common thread runs through all outstanding product design: the judicious use of color. Color highlights ideas. Color makes products more attractive and provides greater choice for customers. Color distinguishes the exceptional from the pedestrian. Just the right shade of color resonates with all of us. And when color and creativity are fused to create something refreshingly new, yet eminently useful, we're all reminded of the human genius for invention.

A DESIGN NECESSITY

Industrial designers know that color isn't simply about beauty; color is a tool to make a better product. Using color to improve products is a design necessity in today's competitive marketplace. Used persuasively, color can help create products that enable millions of professionals to be more productive, help students learn better and faster, and increase safety at the workplace.

But creating the kind of quality products recognized in these pages means applying color effectively throughout the life of a product design. Let's review how color can be infused throughout the design process.

THE INITIAL SKETCH

Different colors convey different cultural clues. Moreover, those clues can change over time. Orange, for example, has not traditionally been a popular color. In the Netherlands, however, the Dutch embrace orange as a joyful symbol of their country's rich history. Educating yourself about how color is perceived, and then experimenting with different colors during the initial design phase, gives a product a voice of its own.

SELLING THE IDEA

The best presentation of a product idea to internal decision-makers and sales professionals is also important during this phase of a product's development. Color printing capability that can convey your vision to the audience with integrity will bring the product to life.

WOWING THE MARKETPLACE

Getting internal approval to follow through on a design idea is one thing. Successfully competing out in the marketplace is another matter entirely. Beating the competition means choosing the colors that convey the right message about the product to the right demographic.

Traditionally, color has been key in winning product designs. When a car company wants to invoke a retro 50's look and feel for their new coupe, candy-apple red drives it home. When an electronics company wants a leading edge color to compliment the leading edge design of their large screen TVs, silver delivers.

The bottom line is that whether a designer uses primary or secondary colors, cool blues or supercharged reds, the colors must resonate well with target customers.

THE FLASH OF INSIGHT

It's been said that genius is one percent inspiration and 99 percent perspiration. We all know that moment of recognition in our own professional lives. The flash of insight that allows you to see a little more clearly, connect the dots, and come up with something new. Choosing the right colors, both for the product itself and for the presentation of your ideas, won't necessarily provide you with additional inspiration, but it will put the finishing touches on an award-winning design.

Text: Mike Brewster
Mike Brewster is a freelance writer based in New York City.
Photo: Spike Mafford/Getty Images
Illustration: Segal Savad

ANNUAL DESIGN AWARDS

WINNERS

THE BEST PRODUCT DESIGNS OF THE YEAR

How do corporations survive in hard times? The Industrial Design Excellence Awards (IDEA) for 2003 show how. This annual contest is sponsored by *BusinessWeek* and juried by the Industrial Designers Society of America. The winners this year used design to push traditional brands into new markets, extend well-known brands into new products, and invent something totally new, cool, and useful. With money tight, companies used design research to develop not only products but also their branding, packaging, and marketing. The impact of this approach goes far beyond the objects themselves.

Indeed, the biggest winners this year used design—and top design firms—to create powerful, emotional consumer experiences. "We have moved from designing iconic objects to designing iconic experiences," says Sohrab Vossoughi, founder of ZIBA Design Inc., which snagged six awards this year, second only to powerhouse IDEO's eight.

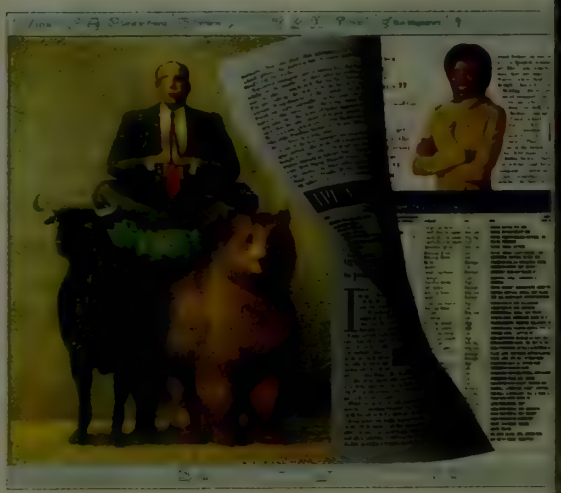
The best example of what it took to win big in 2003 is Logitech Inc., which won six gold, silver, and bronze awards. The info-tech slowdown dented demand for Logitech's famous computer mouse. So it used both ZIBA and IDEO to move into new markets. The gold-winning Logitech Pocket Digital Camera slides open smoothly and is so thin and light that it feels just right in the hand. The product is

GOLD

> **ZINIO READER**

Designers: IDEO and Zinio

Interactive software that recreates the look and experience of reading a magazine, including BusinessWeek



2003

OLD

OGITECH OCKET IGITAL AMERA

esigners: EO, MOTO evelopment roup

Ultrathin igital camera. kes up to 52 nages at 1.3 egapixels. 129

BRONZE

BMW 650 CS

Designer: BMW Design Team Motorcycle (Germany)

Moved gas tank under the seat to ease handling and created new storage in front of rider. $8,690

ANNUAL DESIGN AWARDS

GOLD

MINI COOPER S

Designers: BMW Design Team (Germany)

A redesign and relaunch of a beloved brand from the Sixties. $20,000

GOLD

MOTOROLA V70

Designer: Motorola

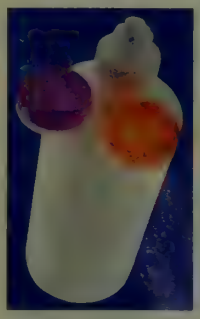
Made for the high-end global market, this wireless headphone swivels to open. $250

more than functional—it's emotional. "Experience design requires s perlative design and engineering execution to deliver on the emotior promise of a new concept," says Tim Brown, CEO of IDEO, which creat the camera, along with MOTO Development Group and Logitech.

The power-of-experience design is evident in the gold-winning softwa Zinio Reader. It combines the magazine reading experience—the tur ing of pages, color images, navigation through headlines and char and advertising—with interactivity. It's simply dazzling, with subscribe able to download video clips and interact directly with advertisers.

The 2003 IDEA contest showed that Asian design continues to gro Samsung won three honors and is now second only to Apple Computer Ir in total awards for the past five years. Motorola Inc. designed a gemlike c phone for the high-end Asian market and decided to sell it worldwide. Indee many products designed in Asia or made for Asia quickly become global. A bea tiful windsurfing sail collection came from Hong Kong is an example.

There was plenty of innovation in this year's winners. Dutch Boy reinvented t paint can, for the first time in 100 years, so there's no dripping (page 72). Herb



SILVER

KABACLIP CONTACT LENS CASE

Designer: Kabalink

First contact lens case that clips on to the neck of a cleaning solution bottle. $8

WINNERS FOR 2003...

Here are many of the winners of the Industrial Design Excellence Award

DESIGN FIRMS	AWARDS			
	GOLD	SILVER	BRONZE	TOTAL
IDEO	3	3	2	8
ZIBA DESIGN	3	2	1	6
RKS DESIGN	1	1	3	5
@RADICAL.MEDIA	2		1	3
DESIGN CONTINUUM		1	2	3
FUSEPROJECT	2		1	3
HERBST LAZAR BELL	2	1		3
LUNAR DESIGN		2	1	3
DESIGN EDGE	1	1		2
DESIGNWORKS/USA	1	1		2
NEWDEALDESIGN	1	1		2
PENTAGRAM		1	1	2
RALPH APPELBAUM			2	2

CORPORATIONS	AWARD		
	GOLD	SILVER	BRO
LOGITECH	2	2	2
BMW	2		2
HEWLETT-PACKARD		1	2
IBM	1		2
SAMSUNG ELECTRONICS	1	2	
WHIRLPOOL	1		2
APPLE COMPUTER	1	1	
BOMBARDIER RECREATIONAL	1		1
MOTOROLA	1		1
NIKE		1	1
TARGET		2	
WARN INDUSTRIES	2		

BusinessWeek online

For a complete list of all the winning products and designers, go to businessweek.com/magazine/extra.htm.

GOLD

NEUROSMITH MUSINI

Designer: RKS Design

By dancing or tapping, kids create vibrations that the Musini transforms into music. $60

GOLD

LOGITECH CORDLESS HEADSET LINE

Designer: ZIBA Design

Wearable mobile-phone products with "ergo-chic" styling. From $14.95 to $99.95

Zar Bell Inc. designed baby nail ppers with a magnifying glass help moms and dads (page 74). IW won a bronze for moving a otorcycle gas tank under the at, opening up room for more rage up front. A Swede came with a two-handed hacksaw age 73), and KabaClip finally ved the problem of the lost con-t-lens case—clip it to the bottle of lens cleaner. As for style, this year's nners showed that flashy color is mostly out. White, blue, and black are There are more straight lines and fewer blobs to reflect leaner times. In 2003, there were 1,279 entries from 15 countries around the world. e 122 winners received 38 golds, 39 silvers, and 45 bronzes. Check out e following pages and our Web site for more great designs.

By Bruce Nussbaum in New York

BRONZE

LOGITECH QUICKCAM

Designer: IDEO

A Web camera for notebook computers. Small, light, and cute. $99.95

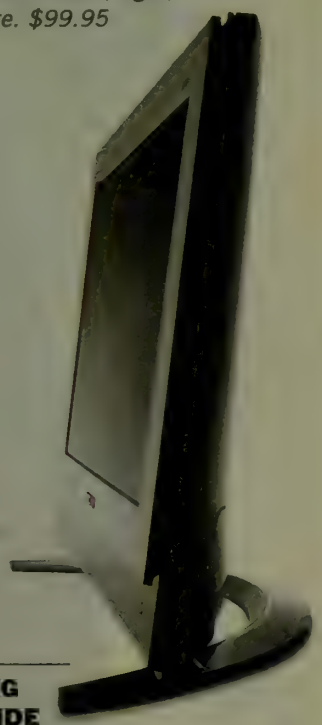
...AND OVER FIVE YEARS

Year after year, some design firms and corporations win:

N FIRMS	AWARDS 1999-2002	2003	TOTAL
	42	8	50
ESIGN	17	6	23
DESIGN	12	3	15
DESIGN	14	1	15
N CONTINUUM	11	3	14
GRAM	11	2	13
T LAZAR BELL	9	3	12
DESIGN	10		10
R	8		8
APPELBAUM	6	2	8

CORPORATIONS	AWARDS 1999-2002	2003	TOTAL
APPLE COMPUTER	17	2	19
SAMSUNG ELECTRONICS	15	3	18
IBM	12	3	15
HEWLETT-PACKARD	9	3	12
MICROSOFT	10	1	11
NIKE	8	2	10
OXO INTERNATIONAL	9	1	10
STEELCASE	10		10
FISHER-PRICE	9		9
BMW	4	4	8
LOGITECH	2	6	8
MOTOROLA	6	2	8
PHILIPS DESIGN	7	1	8
TARGET	6	2	8

ata: Industrial Designers Society of America



GOLD

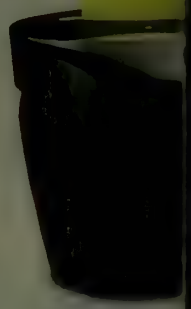
SAMSUNG 17-IN.-WIDE LCD PERSONAL TELEVISION

Designer: Samsung Electronics (Korea)

A curved shape for an LCD TV. Elegant. $1,000

ANNUAL DESIGN AWARDS

Elegance Meets Common Sense



NEW & IMPROVED

In tough times, companies can do well by making existing products better. Dutch Boy took the drippy metal paint can and made it easy to pour, to close, and recycle. Why did it take so long to p on a "lug" lip for drip-free pouring, make a screw-on lid, or atta a simple handle? They're all so obvious. The square pail mak scraping paint off the sides and bottom easier and leaves mo room for advertising on the outside. Michael Graves designed a b ter paper shredder by creating a space at the top to throw out p per clips, fax cartridges, or any trash. Most shredders just shr Another obvious move. Ditto for the milk carton. We all buy milk fat content (skim, 1%, 2%, or whole), not by brand. So Caps Design designed an uncluttered bottle for Schroeder Milk displayi just that. Birkenstock tried another strategy: extending its famo 200-year-old line of comfy footwear into urban markets. By worki with fuseproject founder Yves Béhar and using both traditio and new recyclable materials, it created 35 fresh models for urb hipsters yet stayed true to its sole.

GOLD

DUTCH BOY TWIST & POUR DELIVERY SYSTEM

Designer: Nottingham-Spirk Design Associates

Reinvented the gallon paint can so it doesn't drip. Easy to open and pour. It's about time. $13 a gallon and up

GOLD

BIRKENSTOCK FOOTPRINTS

Designer: fuseproje

Extends hippie chi to a new urban consumer. From $200 to $250 a pa

LVER

PER REDDER

igner:
hael Graves
ssociates
Memcorp
ng Kong)

mbo paper edder, trash , and pencil rpener: $40

GOLD

SCHROEDER MILK

Designer: Capsule Design

No-nonsense packaging focuses on the fat level—skim, 1%, 2%, or whole—to help you quickly choose your milk

SILVER

BAHCO HACKSAW FRAME

Designer: Ergonomidesign (Sweden)

Putting a handle on the front creates the first two-handed hacksaw. $40

GOLD

WINDSURFING SAILS COLLECTION

Designer: meyerhoffer and Neil Pride

A wide see-through window on a racing sail and elegant design. $450 to $550

BRONZE

COMPAQ TC 1000

Designer: Hewlett-Packard

A desktop PC that transforms into a fully functional notebook computer. $1,699

SILVER

COLEMAN MOSQUITO DELETO

Designer: Group 4 and BioSensory Inc.

Lures mosquitoes to their deaths with heat, carbon dioxide, and scent. Portable. $179.99

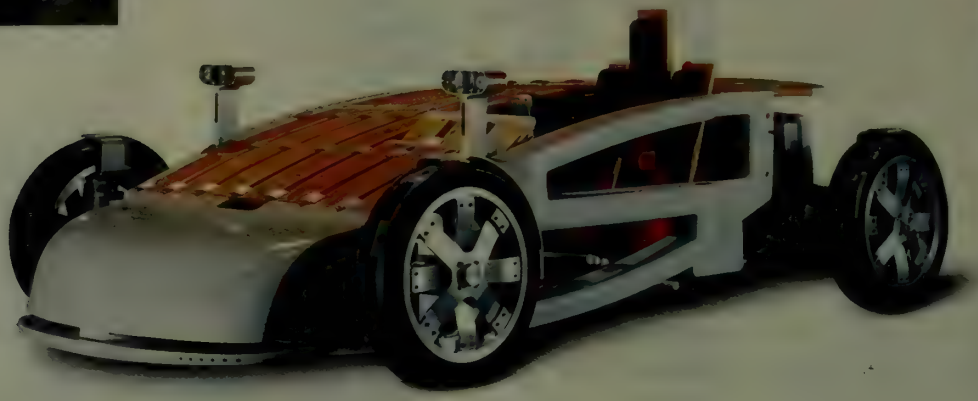
ANNUAL DESIGN AWARDS

SILVER

FORD MA

Designer: Ford Motor

A concept roadster kit, bolted together with bamboo and aluminum, with power train. Minimalist. Estimated price $9,000



SILVER

RAIL PRINTER

Designer: Samsung Electronics

Concept that moves printer from the desktop of a cubicle partition, saving space

Cutting the Cord With TLC

BABY PRODUCTS

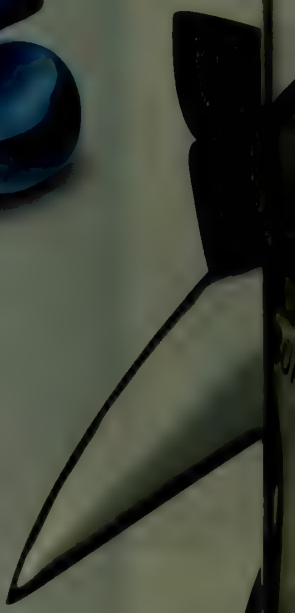
Design Edge captured the emotional side of childbirth in a functional surgical tool, the Joey Clamp. It performs both the surgical cutting and clamping procedures in one single-handed action and attaches a friendly-looking koala character clamp to the baby. It "minimizes the use of 'cold' steel surgical instruments and humanizes the miracle of life," says juror Mark Steiner of Steiner Design Associates. Herbst LaZar Bell Inc. carefully researched both parents' and infants' needs to design its First Year Comfort Care Baby Products. It has scissors that combine small blades with large, adult-size finger rings, nail clippers with a magnifying lens to see a baby's tiny fingernails, and a set of toothbrushes for three different levels of teething. "Great attention has been paid to the choice of material, color, and ergonomic handling," said jury chair Naomi Gornick of Naomi Gornick Associates.

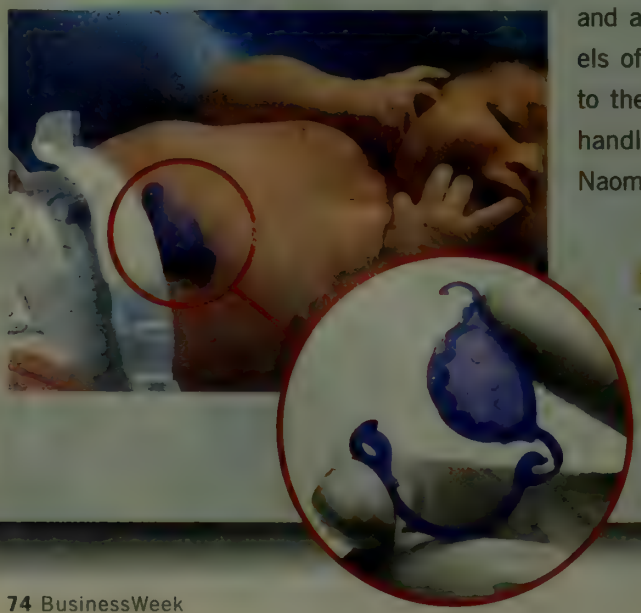
GOLD

COMFORT CARE BABY PRODUCTS

Designer: Herbst LaZar Bell

Nail clippers, scissors, and more. $2.99 to $5.99





GOLD

JOEY CLAMP & CUTTER

Designer: Design Edge

Friendly, simple tool for cutting and clamping a baby's umbilical cord. Save it for posterity. $7.50

eam a
tle Dream

CONCEPTS

Design has always been good at pushing the limits of possibility. The Bombardier unicycle concept takes the gyroscopic advances of the Segway and imagines a unicycle for 2025. Ford Motor Co. goes back to the future with a concept car that is a mid-engine roadster kit that can be put together at home. No welding; only bolts. No painting; just aluminum, bamboo, and plastics. And no hydraulic fluids; it has electric brakes and steering. Think IKEA. Microsoft Corp. envisioned the productivity gains that its future software might generate. It shows how it could work in its Center for Information Work in Redmond, Wash. It uses workplace scenarios to find ways to empower workers, advance collaboration, and speed decision-making. Samsung's clever idea: Shift the printer off the desk to the top of the cubicle wall.

GOLD

MICROSOFT'S CENTER FOR INFORMATION WORK

Designer: Microsoft Design

Center shows long-term vision of writing software that promotes productivity

GOLD

EMBRIO

Designer: Bombardier Design Group (Canada)

Concept for a one-wheel recreational vehicle for 2025. Estimated price: $10,200

ANNUAL DESIGN AWARDS

Dealing with Adversity

SURVIVAL

Philips uses voice prompts and simple graphics to guide household members, office dwellers, boaters, or just about anyone in the use of its small defibrillator. "The designers took the frightening procedure of shocking the heart and simplified the process in an intuitive unit," said juror Mark Steiner. It also simplified the product's assembly and reduced materials to cut its cost. Simple assembly was also key to CAPS, the Contaminant Air Processing System designed for the U.S. Air Force by Survival Inc. Its 1,055 components fit into two 7-ft.-by-4-ft.-by-4-ft. containers, which can be airlifted anywhere and set up without tools. It decontaminates large numbers of people much faster than previous systems. Euforia Design Inc.'s Survival Pod is a watertight medical transporter, shelter, stretcher, first aid kit, and water purifier—all in one unit—used to help flood victims where equipment is limited.

GOLD

SURVIVAL POD

Designer: Euforia Design

Pod that opens as a stretcher, acts as shelter, and contains a water-purification unit. For rescuers to use in floods in Third World countries. Estimated price: $200

GOLD

CONTAMINANT AIR PROCESSIN SYSTEM (CAPS

Designer: Survival Inc.

Decontaminates ma people fast and neutralizes biologic chemical, and nucl agents. Mobile. $22,500

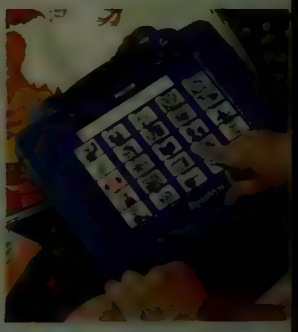
GOLD

HEARTSTART HOME DEFIBRILLATOR

Designer: Philips Medical Systems (The Netherlands)

Heart defibrillator designed specifical for easy use in hom and offices. $2,29

CATALYST AWARD



The Catalyst Award is a separate prize that goes to those well-designed products that have done well in the marketplace. The Delta Pull-Out Spray Faucet helped push Delta Faucet Co.'s market share in that category up from 1.6% to 23.2% in two years. The 470 and 474 pull-out spray faucets are priced from $227.15 to $294.30. Nike's Triax 250 Sports Watch Series designed by Astro Studios and Nike was the company's first brand extension from running shoes into watches. Nike now sells nearly 2 million watches a year, at $85 to $130

apiece, generating $100 million annually. Honorable Ment goes to the DynaMyte Augmentative Communicator, designed Daedalus Excel, LSB Technology, and DynaVox Systems. $6,650 DynaMyte is a portable touchscreen communicator signed for people with disabilities such as seniors who've l strokes, children with Down's syndrome, and people with mu ple sclerosis. Touch words, icons, or phrases and a voice spea

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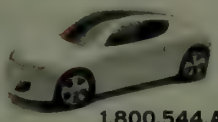

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COMMENTARY

By Otis Port

WILL THIS FEUD CHOKE THE LIFE OUT OF LINUX?

The $1 billion lawsuit that SCO Group Inc. filed against IBM in March is turning into something kin to water torture. Every few weeks, there's a new allegation or announcement from the tiny Lindon (Utah) software company, provoking fears that it will enforce its intellectual property rights against sellers of the Linux computer operating system.

Enough already. True, SCO should be free to protect its software, in this case core pieces of the Unix operating system upon which Linux is based. But its relentless approach to this case could cause irreparable harm to Linux—slowing or even halting its adoption by corporations. Linux is an increasingly popular open-source product, developed by thousands of independent and corporate programmers and given away free, though commercial versions are also for sale. With more than 25% of the market for server computer operating systems, Linux has emerged as the best hope for keeping competition alive in a corporate software market that could otherwise be dominated by Microsoft Corp. Companies need Linux to counterbalance Microsoft's Windows hegemony.

By raising national security concerns, software maker SCO's suit against IBM hamstrings the open-source movement

THE BELL LABS CREATORS OF UNIX, ON WHICH LINUX IS BASED

Fortunately, there may be a relatively painless solution: SCO could identify the pieces of Linux that it believes infringe on its rights. If it turns out that SCO's rights were violated, the open-source community could write replacements for those portions. Meanwhile, arbitrators or the courts could decide whether IBM violated its contracts with SCO and, if so, how much it owes in compensation.

Such an approach was successful once before. In 1992, a similar fight erupted between two camps backing early versions of Unix: the original AT&T Bell Labs program developed in the late 1960s, and a version developed at the University of California at Berkeley. The resolution allowed both flavors of Unix to flourish, says Jon Hall, executive director of trade group Linux International Inc.

But it looks like SCO is in no hurry to reach an accommodation. The more Linux spreads, the larger SCO's potential financial claim becomes. It asserts that Big Blue used copyrighted Unix software code, plus Unix expertise gained in a venture with SCO, to upgrade Linux. Then IBM began marketing Linux in workstations, servers, and supercomputers, boosting sales. And market share gains by Linux have come mostly at the expense of Unix.

SCO President Darl C. McBride says he'd consider replacement of the code, but warns it might not be practical: "When you find out how much code is infringing—the amount is gargantuan—it'd be a major challenge."

Linux advocates, including Hall, aren't sure that's true. They believe that some of the code SCO claims as its own may have come legally from other sources.

Meanwhile, SCO keeps turning up the pressure. On June 16, it amended its complaint in Utah's U.S. District Court, contending that IBM's Linux enhancements violate U.S. technology-export regulations. The new charges relate to Unix's ability to turn a cluster of PCs into a supercomputer powerful enough to use to develop nuclear missiles. Because of that capability, Washington must approve Unix sales to customers in such countries as Libya and North Korea. Now SCO is alleging that by transferring key Unix code to Linux and making it available to everyone over the Internet, IBM is violating the law.

If federal officials decide that Linux merits the same export controls as Unix, experts fear that could end development of Linux by the open-source community. An open-source tenet calls for all improvements to be posted on the Net.

SCO isn't waiting around for the feds before it throws a new dart. Next month, SCO will tell companies that use or distribute Linux, such as Red Hat Inc., that they need to buy a license, says McBride.

That means there's more water torture ahead. In the end, SCO may have a legitimate contract beef with Big Blue. But its tactics are taking too heavy a toll. Unless it wants to be remembered as the company that squelched competition in the corporate software market, it should identify the Unix code that it claims is in Linux so the issue can be resolved as quickly as possible.

Senior Writer Port covers science and technology from New York.

REAL ESTATE

GET YER RED-HOT OFFICE TOWERS

Sellers are putting their trophy properties on the market for big bucks. Did somebody say "bubble"?

If the savvy real estate tycoon Samuel Zell is selling, why are so many others falling over themselves to buy? In May, a private real estate investment trust paid Zell's Chicago-based Equity Office Properties Trust $174 million for the U.S. Bancorp Center—a prominent downtown Minneapolis office tower. This was no fire sale, says Marshall G. Berol of San Francisco's Malcolm H. Gissen & Associates LLC, which manages real estate investments for clients. "Zell is not the kind who sells at bargain-basement prices."

It was just the latest deal for Zell, dubbed "the Grave Dancer" back in the 1980s for turning distressed properties into personal bonanzas. His firm has sold about five dozen buildings in the past year, collecting $800 million, including $255 million just this year. Says President Richard D. Kincaid: "The buildings are worth more today than we thought they were worth, so we sold them."

Good reason to sell, but maybe not one to buy. Bidding wars are pushing up prices fast: The 1,317 office buildings sold in the first quarter nationwide went for a total of $9 billion, vs. the $5 billion that 1,438 buildings fetched in the same period last year. The average price per square foot jumped 13%, to $158, according to CoStar Group Inc., a real estate data firm in Bethesda, Md.

What's fueling this frenetic pace? Simple: interest rates at four-decade lows, plus a rush of new money looking to own something with better returns than bonds and, until recently, stocks. Real estate mutual funds took in $3 billion from investors last year, up from $50 million in 2001. And consider the June 24 initial public offering of American Financial Realty Trust, led by former Salomon Brothers mortgage-securities pioneer Lewis Ranieri: It raised $699 million, the biggest IPO this year, that investors bid up 14% on the first two days of trading.

The money is too tempting to pass up for the owners of many trophy buildings. The feuding partners who own the General Motors building in New York agreed in June to hang out the for-sale sign. Troubled insurer Conseco Inc. and *über*-developer Donald Trump bought the landmark building overlooking Central Park in 1998 for $814 million. Asking price today: about $1 billion, say real estate pros. And Robert J. Sorrentino, president of Bertelsmann Inc., a U.S. arm of German media giant Bertelsmann, said on June 23 that his Times Square green-glass skyscraper is on the market. This is no retrenchment, he adds—it's just smart corporate finance. Bertelsmann, which occupies 400,000 square feet of the 44-story tower, which it intends to lease from the new owner, paid $119 million for the building in 1992. Sorrentino believes it's worth north of $450 million now, money that will help offset sagging book, magazine, and CD sales. "This is the perfect time for those of us who own New York trophy properties to capitalize on their value," he says.

Indeed, even a share in the midtown Manhattan tower that houses *Business-Week*—the McGra Hill building—could sold. The McGraw-H Companies is open offers for its 45% st and could pocket up $600 million, accord to IGDNYC Inc., a N York firm that he companies buy office space. (The Roc feller Group International Inc. owns remaining 55%.) "Because commerc real estate values are at record hig we would likely sell our share if we ceive an attractive offer," says Steven Weiss, McGraw-Hill's vice-president corporate communications.

These days, those attractive off

GM BUILDING
For sale, despite the feud between owners Trump and Conseco

HIGH-PRICED HIGH RISES FOR SALE
What's on the block in big U.S. cities

NEW YORK			CHICAGO	BOS
General Motors Bldg. 767 5th Ave.	666 Fifth Ave.	Bertelsmann Bldg. 1540 Broadway	Random House Tower, 1739 Broadway	Prudential Plaza	0 Boaco
$1.0 Billion	$900 Million	$450 Million	$292 Million	$420 Million	$3 Mil

are most likely coming from private partnerships. Four of them—including Wells Real Estate Funds of Norcross, Ga., which bought Zell's Minneapolis building; Inland Real Estate Group in Oak Brook, Ill.; and CNL Financial Group in Mission Viejo, Calif.—are expected to raise more than $6 billion this year, up from $1.4 billion in 2001, the most since the real estate boom of the 1980s. The buildings they buy will pay off, as long as they can provide leases at below-market rates to attract long-term tenants, says Joe Cosenza, chairman of Inland's acquisitions group, which recently paid $91.3 million for four office buildings.

But if the real estate frenzy turns out to be a bubble, the funds could be playing a risky game. Some private real estate investment trusts put down 30% and borrow the rest at very low rates. But when the economy turns up, so will interest rates and the cost of variable-rate mortgages. Moreover, real estate values may fall as capital flows back into the stock market. "If they are overpaying for these assets now," says Stephanie Krewson, a REIT analyst with BB&T Capital Markets, "it's highly likely they will ultimately suffer huge capital losses."

Such a buyer could end up
n the GM building, for instance. Given
size, tenant mix, and rate of lease
nover, the net annual return could
just 6%, say real estate pros. That
nds pretty good compared with oth-
nvestments, but it's mighty low by
orical standards—and could erode
ckly if vacancy rates and mainte-
ce keep rising. "A 6% return is not
g to make it for most owners," says
ert B. Emden, vice-chairman of USI
l Estate Advisors in New York, a
. consultant for corporate tenants. It
ms this market is not just location,
ation, location, but timing, timing,
ing.

*By Mara Der Hovanesian in New
k, with Michael Arndt in Chicago*

ANCISCO	LOS ANGELES
425 rket St.	Aon Center
230 illion	$125 Million

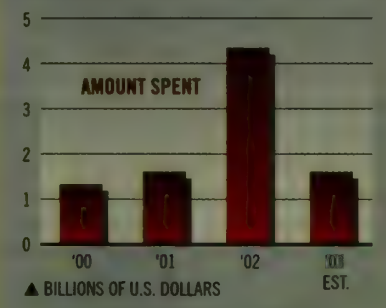
Data: CoStar/*BusinessWeek*

AUF WIEDERSEHEN, PARK AVENUE

Last year, there was no stopping German investors in U.S. real estate. Using America's most prestigious avenues as their personal shopping mall, German institutions outbid local investors and shelled out record sums to snap up choice office properties in New York, Chicago, San Francisco, and elsewhere. Among the purchases: the former Washington Star building on Pennsylvania Avenue in Washington and the UBS Tower at 1 North Wacker Dr. in Chicago. All told, Germans poured $4.34 billion into U.S. commercial real estate in 2002, more than all other foreign buyers put together. "The Germans gave everyone a run for their money," says Warren Bernstein, a partner at Kaye Scholer LLP, a New York law firm that has worked on deals for many German investors.

REAL ESTATE RETHINK

After spending big last year, German investment funds are losing their taste for trophy office buildings in the U.S.



Data: Real Capital Analytics

But that was last year. Now German investors are hesitating. They spent $730 million in the first five months of 2003, including the purchase of the Sotheby's auction house headquarters in New York. But that was a 70% drop from last year, according to Real Capital Analytics Inc., which tracks real estate activity.

At first glance, the about-face seems to defy explanation. U.S. property has gotten much cheaper for European investors with the euro's 30% rise against the dollar in the past year. And a change in German tax law that helped spark last year's boom continues to make it more attractive to own foreign real estate. Meantime, German real estate funds are expected to rake in another $6 billion this year and top $30 billion by yearend, according to German Association of Investment Funds. Given the depressed state of the German market, that money isn't going to stay at home.

So why are the Germans pulling back? The Iraqi war certainly dampened activity. And while the buildings are cheaper in euros, the rents seem puny when converted from dollars back home. More important, a recent drop in yields on prime U.S. properties is making comparable buildings elsewhere in Europe more appealing. "We can get the same return in Britain and the Nordic countries, so why go to the U.S., where the currency risk is greater?" asks the chief investment officer of one Munich-based property fund.

Some Germans remain bullish on the U.S. Aby Rosen, New York managing partner for the German property fund RFR Holdings LLC, says German investors are confident they won't fall into the same trap as Japanese investors in the late 1980s: buying U.S. property at inflated prices just before the market crashed. In his view, "the Germans are not overpaying. [And] they don't expect the market to go up as much as the Japanese did when they bought."

The Germans could yet come roaring back. If the U.S. stock market recovery leads American investors to switch money out of real estate and into equities, and if lower European interest rates reduce the yields on property there, "you're going to see a wave of German funds become very acquisitive in prime properties," says Thomas J. Barrack Jr., chairman and CEO of Colony Capital LLC, a Los Angeles-based investment firm focusing on real estate. "That will add to the bidding frenzy."

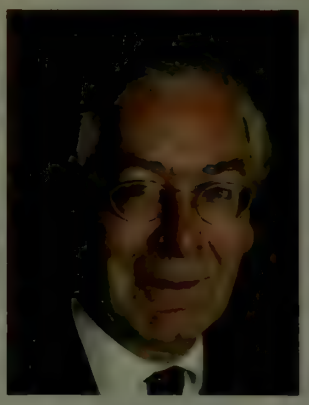
Maybe. But right now German property investors have only $128 million in U.S. deals in the pipeline, according to Real Capital Analytics, so don't expect last year's flood of money to resume any time soon.

By David Fairlamb in Frankfurt, with Chester Dawson and Emily Thornton in New York

CENTRAL BANKING

CHANGING OF THE GUARD

The Bank of England gets a respected new chief



KINGPIN: *Incoming Governor King is an inflation hawk*

Sir Edward George, who retires as Governor of the Bank of England at the end of June, long ago earned the sobriquet "Steady Eddie." In his 10-years as Britain's chief central banker, he deftly weathered more than his share of financial turbulence—from the Asian and Russian crises to the economic fallout from September 11, to the big chill that has gripped global equity markets for most of the past three years.

But as George prepares to retire, the financial markets are showing no signs of distress. That's because his successor, Deputy Governor Mervyn A. King, is widely viewed as the brains behind the bank's solid track record since 1997, the year the bank gained the authority to set interest rates independent of the Treasury. "In my view, it has been the best performer in the G-7," says Francesco Giavazzi, professor of economics at Bocconi University in Milan. "If King had been at the helm of the European Central Bank, we would have a very different monetary union now."

The bank has been instrumental in taming what had been a bucking beast of a British economy. Growth has settled into the 2% to 3% range that many experts consider the country's sweet spot. The healthy economy has whittled unemployment down to 5.1%, among the lowest in Europe. Inflation has hugged the bank's 2.5% per annum target. Most important, investors no longer demand a fat premium to buy British debt. In April, 1997, yields on British government 10-year bonds were almost two percentage points higher than Germany's; now there is little difference between them.

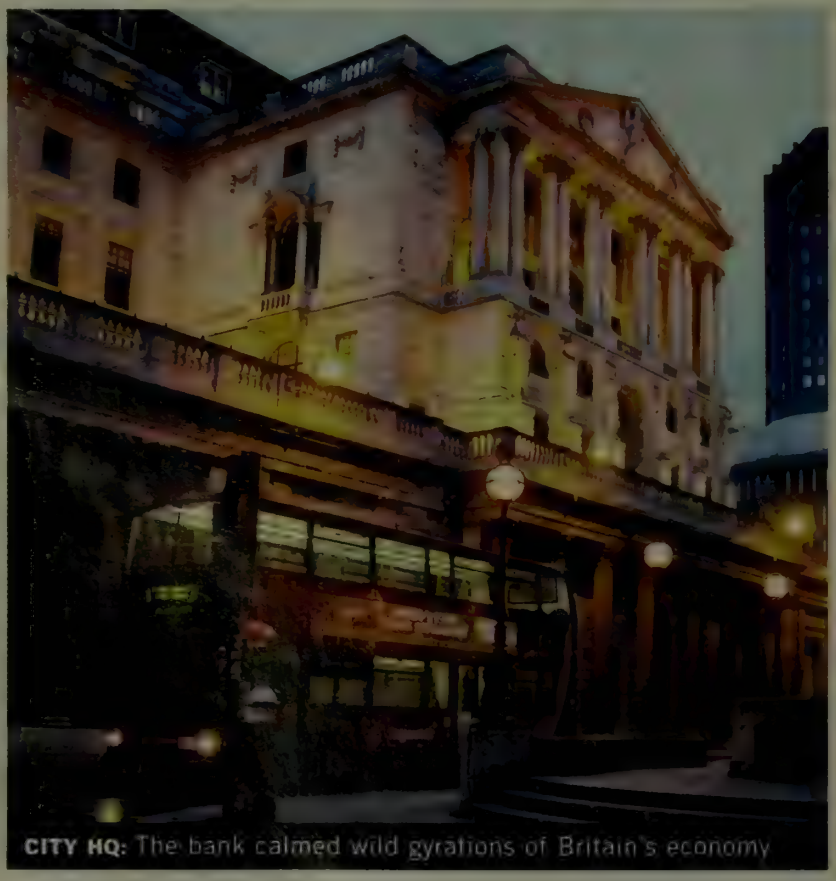
King is given much credit for the changes. He arrived the bank in 1991 from London School of E nomics to serve as c economist in the mids Britain's disastrous ex rience with first join and then abandoning, exchange rate mechan the precursor to the e Other central bankers suspect that perience made King wary of Brita adopting the euro.

King, who declined to comment this article, is viewed as both a for dable scholar and independent thin In mid-2002, before his appointmen Governor was secured, he took a risk by being the only one among nine-member rate-setting Monetary icy Committee (MPC) to argue for a increase. King is hawkish on inflatio to a fault, some critics think.

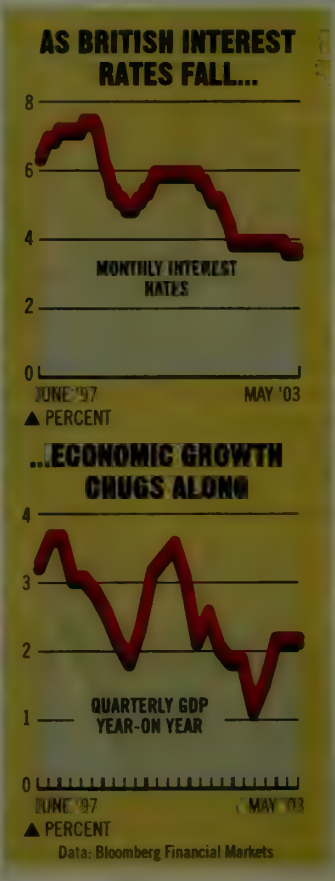
But, with George, he has helped ate the innovative structure that m experts agree has contributed to bank's success. Although known as Old Lady of Threadneedle Street, i anything but cloistered these days enjoys a reputation for being more o than the Federal Reserve—publish detailed notes on MPC discussions posting members' vo on rate moves.

The bank's most e opening innovation been the inclusion four independent me bers on the MPC. T provide real-world voi to balance those of five BOE executives economists on the co mittee, who tend to more hawkish on in tion. "Monetary pol can be taken over technocrats, and that not right," says Rich Portes, a professor London Business Sch

Chancellor of the E chequer Gordon Bro chooses the independ members, and some c ics worry he rewa friends. But for an e nomic policy buff outs the government, gett a seat at the inter rate table is pretty cl to going to finance he



CITY HQ: The bank calmed wild gyrations of Britain's economy

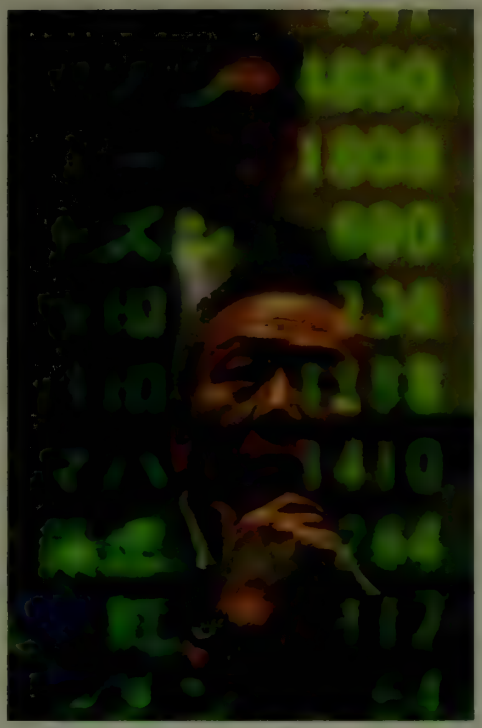


"It is both technically fascinating important," says Stephen J. Nickell, ofessor at the London School of nomics, who recently signed up for a nd three-year term. Nickell says he icularly enjoys the powwows that bank arranges around Britain to its policymakers a chance to see world outside of their mausoleum-headquarters in the City of London. utside Britain, King, a 55-year-old ve of Wolverhampton, in the Mid-s, is well respected. He is a regular icipant at the prestigious annual ral bankers' conference in Jackson e, Wyo., where he is tapped fre-ntly for the challenging role of sum-g up the proceedings. "He's a first-economist and a first-rate—and erienced—central banker," says for-Fed Governor Laurence H. Meyer. ing also gets respect at the Euro-n Central Bank, even if he twits his tinental colleagues in private. "Eddie rge told us that Mervyn thinks we ld have cut rates further and faster earlier and that he thinks the Bank ngland has managed monetary pol-better than we have," says one Eu-ean central banker. "We obviously gree."

ommittee members and bank watch-are waiting for King's first MPC eting on July 9. Some analysts fear as governor, the brainy economist use his mastery of economic re-ch and argument to steamroll the of the MPC. DeAnne Julius, a for-British Airways PLC economist who ed on the MPC from 1997-2001, ks such concerns are overblown. is fully supportive of the open and llenging debate that takes place in committee room," she says.

Whether King wins the plaudits that rge is now receiving will depend on the British economy performs in future. The crystal ball is cloudy. sumer spending, which has sustained wth, is slowing; the outlook for world overy is uncertain; and sterling is ing against the euro but rising inst the dollar. After cutting rates by uarter point in February, to 3.75%, MPC was split in May and June, n nearly all outside members arguing a quarter-point cut, while King and rest of the bank staff voted to hold. he MPC is still torn between worry t growth, now about 2%, could stall fear that further rate cuts would more borrowing by highly indebted sumers. Unless he sees a sharp slow-wn, King is likely to set his face inst a cut—a sort of Steady Merv, might say.

By Stanley Reed in London, with vid Fairlamb in Frankfurt and Rich ller in Washington



JAPAN

A SUCKER'S RALLY?

Japanese stocks are way up. But fundamentals are bleak

The scent of quick money is back in Tokyo. After sliding to 20-year lows, Japan's benchmark Nikkei 225 index has stormed back, up some 17.4% since Apr. 28. On June 17, the index cleared the 9000 mark, closing at its highest point in more than six months, before falling back on June 24.

It's all something of a mystery to many analysts and traders in Tokyo. Japanese stocks are staging a rally in the face of zero economic growth, a banking sector that is still very weak, and the corrosive effects of deflation. And it's hard to make a convincing case that stock prices are foreshadowing a big economic turnaround. "Most economic indicators are trending downward," says Goldman, Sachs & Co. economist Kathy Matsui.

So who's buying? Big foreign-pension and mutual-fund managers. Foreigners represent 48% of the market's turnover, and in April and May, they bought some $16 billion in shares, after being net sellers in the first quarter.

YOKAHAMA INVESTOR: *Foreigners are buying billions more in shares*

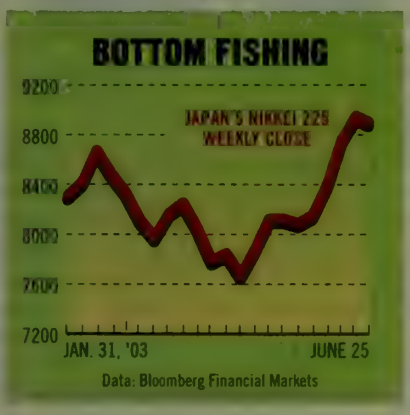
The *gaijin* rationale: Japanese corporate chieftains are making their stocks more attractive with higher dividends and aggressive stock-buyback programs. Buybacks nearly doubled in the year that ended Mar. 31, to $23 billion, with Nintendo, Nomura Holdings, and Toyota Motor leading the charge. What's more, cost-cutting will help fuel an expected 8% rise in corporate profits for the year ending next March. The Japanese economy is in "macro-hell and micro-heaven," says Peter Cundill, who manages two Japan-only funds with $66 million in assets for London-based Peter Cundill & Associates Ltd. Investors are borrowing yen in Japan at near-zero rates, then investing in companies that offer dividend yields of 2% to 3%, he points out.

Sensing that the time is right, Japanese companies are raising money in the equity markets. NEC Corp.'s chip-making unit plans a separate listing on the Tokyo Stock Exchange in July. And ink-jet-printer maker Seiko Epson Corp. listed its shares June 24 in an initial public offering valued at $1.1 billion; its shares jumped 35% in the first day of trading. Indeed, after the total value of Japanese IPOs slumped last year to the lowest level in five years, HSBC Securities Inc. is forecasting a 13.5% rise, to $4.2 billion, this year.

Some strategists think the Nikkei could hit 10,000 by the end of the year, but the hurdles are many. For instance, Japan depends on a healthy American appetite for everything from DVD recorders to luxury cars. But if the yen continues to strengthen from its current 118 to the dollar, as many analysts believe it will, then exporters will start feeling pinched. Moreover, the market's revival is very narrowly based: Fewer than 225 stocks—or 15%—on the Topix, or first tier of the Tokyo Stock Exchange, are at 52-week highs. That has to change before the Nikkei really takes flight, analysts say. "It is still a thin crust of companies that have made improvements," says Jeffrey D. Young, an economist with Nikko Citigroup in Tokyo.

Optimists should remember that back in 1999, plenty of fund managers and brokers screamed "Buy Japan." Three years later, it has become clear that wise investors sold Japan instead.

By Brian Bremner in Tokyo



THE PENTAGON

INSIDE BOEING'S SWEET DEAL

Is it a stealth bailout by the military or just smart business on both sides?

It seemed like a good idea at the time. The U.S. Air Force needed tanker planes to refuel its jets, Boeing Co. needed orders. Pentagon purse strings were tight, but with creative accounting and strategic politicking, Air Force brass and Boeing executives crafted what they see as a stroke of bureaucratic brilliance: a $19.6 billion deal under which the service will lease 100 new 767s to replace its KC-135s tankers, and Boeing's production line will keep humming.

That was before the firestorm. The novel deal has drawn heat from all sides. Watchdog groups on the Right and Left see it as a brazen Boeing bailout. Defense Dept. civilians say Boeing was asking too much, while others say a lease's finance charges drive up the cost. Even just-departed Budget Director Mitch Daniels at one point called the idea "irresponsible." Senator John McCain (R-Ariz.) blasts the arrangement as a "profligate waste of federal revenues." And at least three congressional committees are looking into the deal, which could still be blocked.

The tanker lease—and the unusual and secretive way it was developed—raised plenty of red flags during an intensive review by *BusinessWeek*. Congress awarded the lease to Boeing before any hearings or competing bids. To make leasing seem cheaper than buying, the Air Force tinkered with key assumptions about the planes' cost. The agreement includes a potential 15% profit for Boeing, triple its margin on commercial planes. Without high-powered lobbying—reaching right into the Oval Office—Boeing couldn't have overcome objections from White House budgeteers and the top echelons of the Defense Dept.

The implications go far beyond this deal. By leasing instead of laying out the cash upfront to buy the planes, the Air Force pushed spending into the future, allowing it to get new tankers without cutting other programs. And the Pentagon plans more leasing, potentially rewriting the rules for how it spends $200 billion a year. "The precedent is horrific," says Keith Ashdown of Taxpayers for Common Sense, a watchdog group. Leasing could "become this end run around procurement."

After being lobbied on the deal by Hastert and Dicks, President Bush told Staff Chief Card: "Andy, let's get it done"

A huge policy shift wasn't on anyone's mind in February, 2001, when Boeing execs approached the Air Force with an idea: Why not buy planes from Boeing's languishing 767 production line to replace the service's tanker fleet? The 545 KC-135s—43 years old on average—account for 90% of the Air Force tanker fleet.

A month later, Chicago-based Boeing created a unit to sell its widebodies as tankers. Its goal: Capture foreign markets, then return to the U.S. for sales. Later that year, Boeing beat out European Aeronautic Defence & Space Co. (EADS), parent of Europe's Airbus, to sell four tankers to Italy and four to Japan.

TROUBLING ISS FOR BOEING

Why the tanker deal is drawing fire

September 11 injected urgency i Boeing's Pentagon strategy. Comm cial airlines were in a tailspin, and B ing was caught in the downdraft. commercial workforce shrank fr 127,000 to 65,000 today. Meanwhile, war on terror put a premium tankers. Missouri-based B2 stea bombers had to refuel five times route to Afghanistan, while patrols o 27 U.S. cities put F-15 and F-16 fight in the air for 12-hour shifts.

Boeing saw an opening. The Force saw "a motivated seller" will to sell low, says Marvin R. Sambur, service's acquisition chief. Since a p chase would require full funding front, which the Air Force didn't hav lease seemed to be a solution. With terest rates low, a lease could appro the purchase price. The costs could spread over 11 years, from 2006 to 2

Boeing brought the idea to Ho Speaker J. Dennis Hastert (R-I whose state is home to Boeing he quarters. In December, 2001, Hast

ARTIST'S RENDERING OF A 767 ON A REFUELING MISSION

lanes costs more
ng them outright.
orce says this
heaper, but only
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savings not
d in a purchase.

GIMMICKRY

To structure the deal as an operating lease, the Air Force had to pretend it did not plan to buy the planes later. To close the deal, the White House promised to lease hundreds more jets.

LOBBYING

Key lawmakers from Illinois and Washington State were calling in White House chits to push the tanker-plane-leasing deal past reluctant Pentagon brass and budgeteers.

UNNECESSARY?

Replacing tankers wasn't a top Air Force priority. But now the service says its current planes are rusting, driving up maintenance costs and raising fears they'll be grounded.

s say, he and Senate Appropriations
mmittee Chairman Ted Stevens (R-
ska) agreed to slip wording into a
2 funding bill to let the Defense
t. lease 100 Boeing 767s as tankers
four 737s for VIP transport. "The
on that this would help Boeing at a
e when they were facing trouble was
lost on anybody," says a top Senate
e. "The question is whether or not
delegitimizes the other goals."
ome lawmakers and watchdogs say it
s. "It appears to be a corporate sub-
," charges Grover Norquist, presi-
t of the conservative Americans for
Reform. The Office of Management
udget's Daniels argued the lease
ld cost more than a purchase. De-
e Secretary Donald H. Rumsfeld and
aides questioned the price tag. And
Air Force at that point hadn't made
kers a priority since 80% of deployed
kers were always ready to fly.
Under pressure, the Air Force asked
s to submit a bid in early 2002. The
pany claims its offer was 40% cheaper than Boeing's. But EADS's plane didn't meet Air Force specs. Boeing would be the winner—if there were a deal.

That was still no certainty. So Boeing and its allies ratcheted up the political pressure. Representative Norm Dicks (D-Wash.) tried to bring top Defense officials along; Hastert worked the White House, Dicks says. Boeing dispatched Continental Airlines execs to show Pentagon brass how commercial aircraft leases work. "The Air Force was using our commercial aircraft agreement to benchmark against Boeing's," says Continental spokesman Rahsaan Johnson.

Boeing also rallied its suppliers. "We encouraged them to be part of the debate," says Rudy F. deLeon, head of Boeing's Washington office and a former top Pentagon official. DeLeon had reason to be optimistic. Beyond support from congressional heavy hitters, Boeing and its employees had made $2 million in political donations in 2000, including a $100,000 company gift to George W. Bush's inaugural committee, according to the Center for Responsive Politics. Senate filings say Boeing's 2002 lobbying budget totaled $6.3 million.

Boeing also hired the Air Force's No. 2 acquisition official, Darleen Druyun, in January, 2003. Lawmakers and watchdog groups question whether she favored Boeing while negotiating the tanker deal on behalf of the Pentagon. Boeing says it didn't approach Druyun until after she retired in November, 2002, and she hasn't been involved in the tanker bid since.

But Boeing's ace in the hole turned out to be Bush. Hastert had broached the lease in private sessions with the President. At a White House meeting in October, 2002, Dicks chimed in with concerns that age-related flaws could ground the fleet. As Dicks told *BusinessWeek*, "if there's a failure of these planes and you can't fly them, we're screwed." Bush listened to his pitch, Dicks says, then turned to White House Chief of Staff Andrew H. Card Jr. and said: "Andy, let's get it done."

Even with Bush on board, closing the

deal proved daunting. In December, 2001, OMB had pegged the total cost at $26 billion—$150 million a plane. The price later dropped further below the $175 million or so the Japanese and Italians paid for their tankers, according to the Air Force's Sambur. But Rumsfeld's office continued to dig in its heels. "Each time we pushed back, the deal got a little better," says one top Rumsfeld aide.

To do the lease, Boeing and the Air Force had to prove that it would cost less than buying the planes. That required financial alchemy on two critical assumptions. First, the Air Force stretched out the period it used for calculating the costs. That reduced the present value used to compare the lease to a purchase. Then, the Air Force assumed efficiencies from a multiyear deal,

Hastert had just steered Bush's tax cut through Congress. Now he wanted Card to seal the lease deal

based on Congress's O.K. Sambur says he couldn't make that assumption for a purchase since Congress had not approved a multiyear buy. Presto: a cheaper lease. "It may be bad accounting and marginally more expensive," says Thomas Donnelly, an American Enterprise Institute defense expert who backs the deal. But "anybody that can game the system, more power to 'em."

Other analysts disagree. Steven M. Kosiak of the Center for Strategic & Budgetary Assessments argues that the Air Force should use the same terms to compare buying and leasing—and that a purchase is cheaper. "They're not willing to recognize the true costs of the program," he says. "They're pushing the can down the road."

Fights over the number-crunching produced a stalemate. Anxious to break the logjam, Hastert contacted Card in early May, 2003, to call in a chit, says a Hastert aide. Hastert had navigated Bush's $350 billion tax cut through Congress. Now he wanted Card to seal the lease deal. Hastert called Card several times over the next three weeks, says the aide. And Card called Boeing CEO Philip M. Condit twice, Boeing officials say. A White House spokeswoman said Card was seeking to protect taxpayers.

Card's message, according to Hill sources: Boeing's price was $4 million per plane too high. But he held out a sweetener—a promise that the Air Force would order hundreds more tankers later. Additional orders let Boeing reduce its price further, to $138 million a plane. But that was still high, according to a study done for Rumsfeld's office.

A May 15 meeting involving Condit, Air Force Secretary James G. Roche, and OMB officials helped break the deadlock. Condit agreed to give the feds a rebate if Boeing sold the tanker at a lower price elsewhere, and to cap its profit margin, which meant any efficiency gains would flow back to the Pentagon. The profit cap was especially unusual because defense outfits reap higher margins as they cut production costs on fixed-price contracts.

But the concession helped close the deal. On May 22, Card told Hastert he had an agreement. The contract—a $15.5 billion series of six-year leases, plu $4.1 billion option to buy—was unve the next day at the Pentagon. In a t statement, OMB's Daniels praised the ings over earlier proposals.

EADS execs say they've been pr ised the chance to bid on the n round. "We fully intend to participat future U.S. mission aircraft prograr says Ralph D. Crosby, chairman CEO of EADS North America. But shouldn't hold his breath. "A Fre owned company is never going to b an airplane for the U.S. military," Hastert spokesman John Feehery.

Despite Boeing's concessions, tanker lease still faces opposition. Cain vows to subpoena company d ments and plans hearings in his C merce Committee. Senate Fina Committee Chairman Charles E. Gr ley (R-Iowa), a tenacious Penta pork-fighter, questions the deal. Pentagon civilians are holding up a quired report to the Hill by challeng Air Force calculations that make lease look more economical.

Critics also ask whether a comp with Boeing's track record should handed such a groundbreaking d Boeing recently acknowledged that ployees stole secret documents from val Lockheed Martin Corp. on a dif ent contract. "They have been guilt several transgressions," McCain s "This leasing deal should not be proved until there is a full invest tion." The Lockheed Martin controve and the tanker lease "are not relat Boeing said in a statement.

Critics have already scored some tories. What started as a clear-cut sw heart deal for Boeing at $26 billio now a far better package for taxpay and the Pentagon. But the benefits Boeing go far beyond the $19.6 bil price tag. With Airbus poised to dc nate the commercial market, good n for Boeing has been rare. The tan deal just might give America's N aerospace company a new lease on l

By Stan Crock and Lorraine Woel in Washington, with Stanley Holme the Paris Air Show

HOW THE DEAL CAME DOWN

FEBRUARY, 2001 To bolster its near-idle 767 production line, Boeing suggests that the Air Force buy widebodies converted into tankers.

SEPTEMBER, 2001 Travel sinks after September 11, slashing Boeing's 767 order backlog to 27 jets. War in Afghanistan puts premium on tanker capacity.

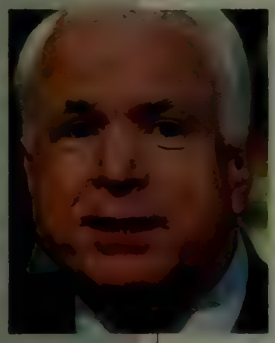
DECEMBER, 2001 Air Force and Boeing explore converting proposed sale into a lease. Congress authorizes 100-plane lease with no competing bids.

APRIL, 2002 EADS submits rival proposal it claims is 40% cheaper. Doesn't meet specs and is rejected.

OCTOBER, 2002 Hastert and Dicks lobby Bush.

MAY, 2003 In calls to Condit, Card promises future orders of hundreds more tankers. Boeing lowers price.

JUNE 24 As Air Force and Boeing finalize details, hearings by House Armed Services Committee launch first of three congressional reviews of the lease.



"This leasing deal should not be approved until there a full investigation," McCain says

evelopments to Watch

JOHN CAREY

June 22-25, biotech execs scientists descended on hington for the industry's ual, 15,000-strong BIO ting. They pitched their ms, drugs, and technolo- venture capitalists, big makers, and other po- ial supporters. Senior respondent John Carey these reports:

EFING UP RN AND YBEANS

ECH HAS LONG HELD THE nise of producing more ritious crops. Soybeans, example, are a good ce of protein but are de- nt in amino acids such as ne, which humans need. enetic engineering can retically correct deficit. Unfortu- ly, "the technology such output traits is plicated," says Ganesh Kishore, vice-presi- for technology, culture, and nutri- at DuPont. So lucers of gene- ed crops have sed instead on ts that are to fight pests olerate herbicides. ow, DuPont researchers they have succeeded in ing a single gene to corn causes the grain to boost duction of no less than amino acids. The compa- has also added the genes lysine and methionine to beans, successfully fash- ning plants that make more of these amino acids. The soybeans are al- ready being tested in the field, and the new corn will be planted this year, says Kishore. The first use of these crops, he antici- pates, will be as animal feed.

SOY: *Soon, more aminos*

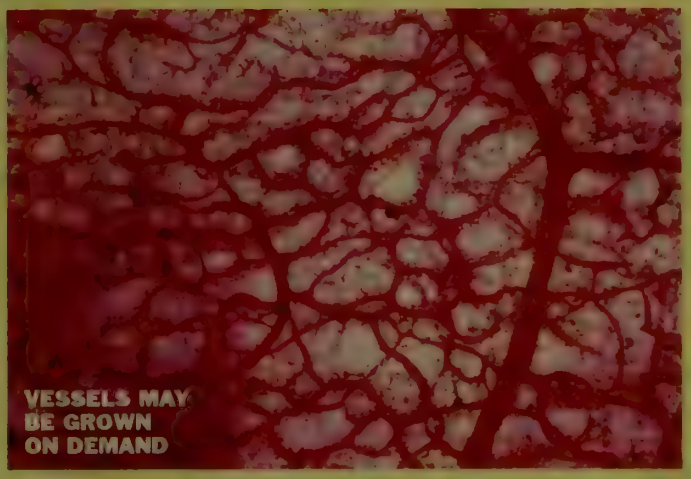
DRUGS THAT KNOW WHAT GENE THEY'RE AIMING FOR

NOW THAT SCIENTISTS HAVE read the human genome, drugmakers are faced with a surprising problem: too many potential targets for drugs. Even one disease, such as diabetes, may involve 100 or more genes. Companies have spent years developing drugs only to learn they are hitting the wrong genes or proteins.

Isis Pharmaceuticals in Carlsbad, Calif., claims it can deal with this complexity. The idea is to hit all the potential targets in a disease. "We can begin with a set of unknown genes and be in the clinic in less than 12 months," says Isis CEO Dr. Stanley Crooke.

Isis scientists make strands of DNA, called antisense DNA, that block genes from making their proteins. By creating a collection of antisense compounds, researchers can disable each gene in a disease.

That points the way to promising treatments. Working in diabetes, the company has found an antisense drug that reduces high glucose levels without allowing blood sugar to drop too low—a common problem with current drugs.



VESSELS MAY BE GROWN ON DEMAND

AN ON-SWITCH FOR VEIN GROWTH

TO TREAT HEART DISEASE, DOCTORS OFTEN OPEN UP OR replace blocked arteries. But there may be a better way: growing new blood vessels. "That would be truly spectacular technology if it could be delivered," says Michael A. Mussallem, CEO of Edwards Lifesciences.

It hasn't been done yet. But one promising tack comes from Sangamo BioSciences in Richmond, Calif., whose technology is licensed to Edwards Lifesciences. The idea is to turn on the body's own gene for a protein called vascular endothelial growth factor (VEGF), which prompts the formation of new blood vessels. Sangamo scientists have designed proteins, called transcription factors, that bind to specific bits of DNA. Hit the right spot, and the targeted gene is activated.

In one experiment at Duke University, researchers used the transcription factor drug to turn on the gene for VEGF in rabbits, after removing an artery in one leg of each animal. The result: more vessels and increased blood flow to the legs after being treated. "We are extremely excited about the data," says Dr. J. Tyler Martin, Sangamo's vice-president for development. The company expects to apply to the FDA within a year to test the drug in people with damaged blood vessels in their legs.

PLUG-AND-PLAY VACCINES?

TEN YEARS AGO, GENVEC was founded to cure disease by delivering new genes to people with illnesses such as cystic fibrosis. So far, such gene therapy hasn't led to products. But the Gaithersburg (Md.) company believes its technology will pay off—in vaccines.

The approach starts with a weakened version of a microbe called an adenovirus. Into this, scientists insert genes for a deadly bug, such as HIV. People who are given the rejiggered adenovirus won't contract AIDS. The added genes prompt cells to make HIV proteins, stimulating an immune response that may protect against infection.

GenVec has been working with the National Institutes of Health on an AIDS vaccine. But when the SARS epidemic hit, CEO Paul H. Fischer realized that his technology could be quickly adapted for the new illness. All the company's scientists needed was the genetic sequence. "For SARS or any other rapidly emerging biothreat, we can go directly from the genetic blueprint to make a synthetic gene and put it in the adenovirus vector," he explains.

In 15 days, GenVec hammered out an agreement with the NIH to make the vaccine against SARS.

PHOTODISC GREEN/GETTY IMAGES (SOYBEANS); BIOPHOTO ASSOCIATES/PHOTO RESEARCHERS INC

MEDIA

THIS IS THE DAWNING OF THE AGE OF—XM?

The satellite radio service is picking up subscribers fast—but competition and cash burn are big worries

Gary M. Parsons was planning to spend September 11, 2001, preparing for the debut of XM Satellite Radio's new service. The chairman was scheduled to host a launch party on Sept. 12 at the Washington company's state-of-the-art studios with celebrities like Quincy Jones and Ziggy Marley. But on his drive to work that Tuesday, as he crossed the Potomac River on the 14th Street Bridge, Parsons saw a fireball explode at the Pentagon. Just like that, XM's grand affair seemed inconsequential. He pulled the plug on the party and canceled an ad campaign featuring Snoop Dogg falling down the side of a skyscraper. "Very little that day was going through my mind about XM," says Parsons.

Despite the rough start, XM is beginning to take off. Since launching without fanfare on Sept. 25, 2001, the company's crystal-clear, digital radio service delivered via satellite for $9.99 a month has started to catch on. Some 600,000 subscribers have signed up so far, and Parsons expects 1.2 million by yearend. The attraction? Customers can choose among 101 different stations, offering everything from classical to alternative rock, from BBC news to ESPN sports coverage. And because XM is delivered from satellites that cover the entire continental U.S., stations never fade out when listeners are driving, like traditional AM and FM stations do. "I don't think I can be without XM now," says Brad Johnson, a 36-year-old technical systems manager at Pepperdine University who listens during his hourlong morning commute.

Will others catch the rhythm? XM's primary competition is traditional AM and FM radio, which may not have the breadth and coverage of the satellite service, but has the distinct advantages of being free and available on standard car and stereo equipment. XM requires that customers pay $200 or so up front for equipment along with its monthly subscription fee. It also has a rival in New York's Sirius Satellite Radio Inc. Sirius, which costs $12.95 a month for 100 stations, is completely commercial-free, while XM has a small amount of advertising. Sirius has signed up 100,000 subscribers.

Perhaps the biggest worry is XM's own pocketbook. Even after restructuring its debt last year, the company is expected to lose $562 million this year on revenues of $85 million. It's burning through an estimated $20 million in cash a month and has just shy of $400 million in the bank. Some analysts think XM will hit 2.5 million subscribers and begin to generate cash from operations by the end of 2004. Slower subscriber gro however, could prove troublesome will be close," says lyst April Horace vestment bank J Partners Inc., thinks XM has en cash. "If they make subscriber g the business plan is at risk."

CHAIRMAN PARSONS: *A passion for radio since childhood*

Real profits will take a bit longe cover its capital and interest costs needs to reach 7.5 million subscribers about $1 billion in revenues. Deut Bank Securities Inc. expects the com will hit those figures in 2008.

To reach those targets, XM will g little help from its friends. General

MUSIC TO AN ENTIRE FAMILY'S EARS

You want to hear about the latest disruptive technology? The sound emanating from the XM satellite radio system I borrowed for this review was so loud, so powerful, and so clear that it rattled the entire household for the better part of a weekend. My wife liked the dance music, our 7-year-old liked the Top 20 station, and our 2-year-old thought it worked well as a football. A near-riot erupted when I packed it up and took it back to the office.

XM's appeal is visceral. Having spent countless hours of my life flipping through the AM and FM bands in often-fruitless searches for worthwhile music or news, XM is like an oasis in the desert. Regardless of your tastes, there is always something on. And for anyone who has ever been frustrated with the terrible reception and limited the typical radio, XM will provi come relief. For those reasons well worth $10 a month.

None of this is to suggest tl medium is perfect. For all its lacks depth. It offers solid jazz but none of it rises to the leve favorite FM radio station, publi jazz powerhouse WBGO in New

(TOP) PHOTOGRAPH BY KATHERINE LAMBERT

SATELLITE RADIO POWERS UP

Satellite radio is catching on, with some 700,000 subscribers today and forecasts for 1.5 million by yearend. Here's the skinny on this new digital music and news service:

WHAT IS SATELLITE RADIO? These systems beam CD-quality signals from space to special radios, most of which are installed in cars. Customers also can listen at home or on the go.

WHERE IS IT AVAILABLE? Two carriers offer nationwide coverage. XM, based in Washington, D.C., is $9.99 a month; Sirius, based in New York, is $12.95.

WHAT DO YOU GET? The services offer about 100 channels. Sirius is commercial-free, while XM broadcasts a limited number of ads. Programs range from music to news and comedy.

WHO IS BACKING SATELLITE RADIO? Carmakers, which are eager for a stake in a new, fast-growing business. GM funded XM, and DaimlerChrysler is backing Sirius. Others are picking one of the two technologies, which are not currently compatible.

DO MOST CARS HAVE SATELLITE RADIO? The systems are available on many new models for about $300. Within two years, satellite radio is expected to be available on many new cars.

WHAT ABOUT HOME AND PORTABLE SYSTEMS? You can buy a palm-size receiver from Sirius or XM. They're available from retailers like Circuit City and Wal-Mart for about $200, including adapters. You can carry these, using them at home or in the car. For an additional $99, XM's can be used with a special portable boom box.

Data: Company reports

Corp., which invested $100 million M in 1999, plans to make satellite o available in almost all of its cars. he end of this year, 44 of GM's 57 lines will come equipped with XM rom 25 last year. Toyota and Honda are signing on. That's not all. Cus-ers can sign up for XM radio in r homes if they pick up specially pped boom boxes available through or retailers like Best Buy, Circuit , and Wal-Mart Stores. For his , Parsons has no doubt XM's satel-radio will attract legions. "It will ge the way people listen to mu-news, and information," he says. ce you've heard it, you can't be out it."

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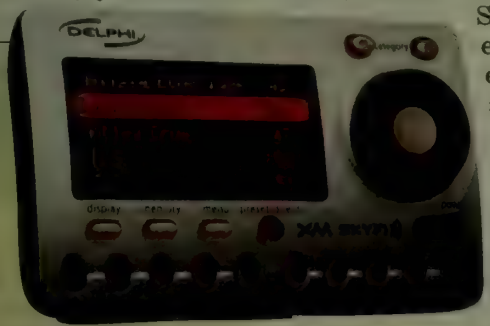
By Steve Rosenbush in New York



WANNA DANCE? *XM tuner*

Parsons brings years of experience to the venture. The middle child of a homemaker and an exec of a fishing rod company, Parsons, 53, grew up in Columbia, S.C. After graduating with an engineering degree from Clemson University and an MBA from the University of South Carolina, Parsons worked 10 years for BellSouth Corp. He caught the entrepreneurial bug after his wife, Kathy, started her own ad agency. "She proved to me you could do it and not starve," he says. After Ma Bell's breakup in 1984, Parsons joined long-distance startup Telecom*USA, went to MCI Communications in 1991, and six years later, became CEO of American Mobile Satellite, a data-services company that was experimenting with satellite radio. He decided to push the project, and XM was born.

Even as a boy, Parsons demonstrated a passion for radio. While in high school, he worked as a disk jockey playing contemporary music nightly on "Gary Parson's Night Flight" at WKDK-AM in small-town Newberry, S.C. But that job cost him. After he was elected student-body president, school officials ousted him from the president's post because they didn't want a deejay representing the school. "Gary made a big stir," recalls older brother Jim, a construction company manager. "Radio tends to get in your blood," explains Gary.

That passion helped fuel Parsons through XM's touch-and-go moments. The most dramatic occurred last year when XM was running out of cash and its survival was at stake. Last fall, GM agreed in principle to stretch out the payments it was owed by XM, but the auto maker wouldn't defer collection unless XM could get fresh money from private investors. George Haywood of New York and Rick Barry, managing director at hedge fund Eastbourne Capital Management LLC, were interested, but they wanted a commitment from GM first. By October, the two sides were at a stalemate.

Parsons almost scared up cash elsewhere. NBC considered investing a significant amount but backed out in early December after it decided "it wasn't the right time," according to NBC Executive Vice-President Brandon Burgess. The New York Times Co. was going to kick in $25 million, but dropped out after defects forced XM to accelerate the launch of a spare satellite, according to Eastbourne partner Eric Sippel. New York Times officials declined to comment.

With cash running out, Parsons went

back to GM. Since the last round of talks, GM had more time to study the sales of XM-enabled Cadillacs. The numbers were so impressive that GM executives were convinced XM's potential was enormous. Once GM committed, other investors quickly followed. At 5 a.m. on Dec. 23, GM led a group of investors in a $450 million refinancing for XM. GM deferred until 2006 $250 million in payments that XM owed it for loans, bonds, and revenue-sharing plans. A group that included Haywood, Barry, Honda Motor Co., and Hearst Corp. put in $200 million in new cash. In return, XM agreed to develop data services, such as weather and traffic, for Honda cars.

XM's success rests on more than just financial engineering. Parsons and his partner, CEO Hugh Panero, made several smart moves that helped it pull away from rival Sirius. The most important one came five years ago. XM decided to develop its radio chipset in-house, while Sirius outsourced its chip design to what is now Agere Systems Inc. Sirius' chips were delayed, which gave XM a year's headstart in the market, says Horace of Janco Partners. An Agere spokeswoman says it's common for complex chips to go through several revisions.

Last year, XM also decided to design a new line of radios in-house. Sold at retail stores, the easy-to-install radios have lowered XM's cost of subscriber acquisition to $74 in the first quarter, compared with $125 at the end of last year. XM pays only $35 to subsidize each of these radios, compared with $130 for its original radios.

There are still plenty of challenges ahead. XM must achieve its subscriber target. It faces plenty of competition from other technologies, such as the Internet, where downloading music is popular and often free. But XM is betting that young users will be just as excited by the prospect of mining XM's vast selection of new and unexpected music. And the quality of XM's sound is generally superior to anything that can be downloaded from the Web, let alone captured on AM or FM radio. "XM is a different definition of what we've heard all our lives," says Quincy Jones, who advises the company on its programming.

XM has defied the odds so far. That's why many analysts and investors believe the company can achieve its goals, signing up nearly 10 million users by the end of the decade. If it can do that, it may yet have a shot at the stratosphere.

By Catherine Yang in Washington, with Diane Brady, Adam Aston, and Steve Rosenbush in New York

STRATEGIES

DELTA'S FLIGHT TO SELF-SERVICE

Its new systems zip travelers onto planes–and cut costs

Stuart Klaskin's flight on Delta Air Lines was leaving in just 20 minutes. But even though he raced through New York's LaGuardia Airport, the behind-schedule aviation consultant suspected he would make it. Why? He bypassed the long check-in lines, stopping instead at one of Delta's new automated kiosks, where all he did was insert his frequent-flier card to get a boarding pass. Not only did Klaskin make his flight but, he says, "I even had time to get grab a cup of coffee."

A year ago, Klaskin would probably have ended up on standby for the next flight out. But Delta recently embarked on a $200 million, three-year technology makeover that is aimed at changing the way people use airports. The third-largest U.S. carrier has already installed 670 self-service kiosks in all 81 of its major domestic terminals. There, passengers work with a check-in screen to find a seat and print out a boarding pass. Got luggage? That still has to be dropped off with an attendant, who matches it with a label generated by the kiosk. But the lines are shorter these days. And some of the same people who used to stand behind the counters now greet arriving passengers and show them how to use the technology.

Kiosks are just the start. Delta is using everything from high-definition screens providing real-time info to direct phone access to reservation agents to speed up travel. While its rivals use similar technologies, Delta is the first airline to package it all as a comprehensive, hassle-free system. "We are pioneering significant changes in the way passengers will move through airports," says Richard W. Cordell, Delta's senior vice-president for airport customer service. "In two years, 80% of our passengers will check in somewhere other than the old counter."

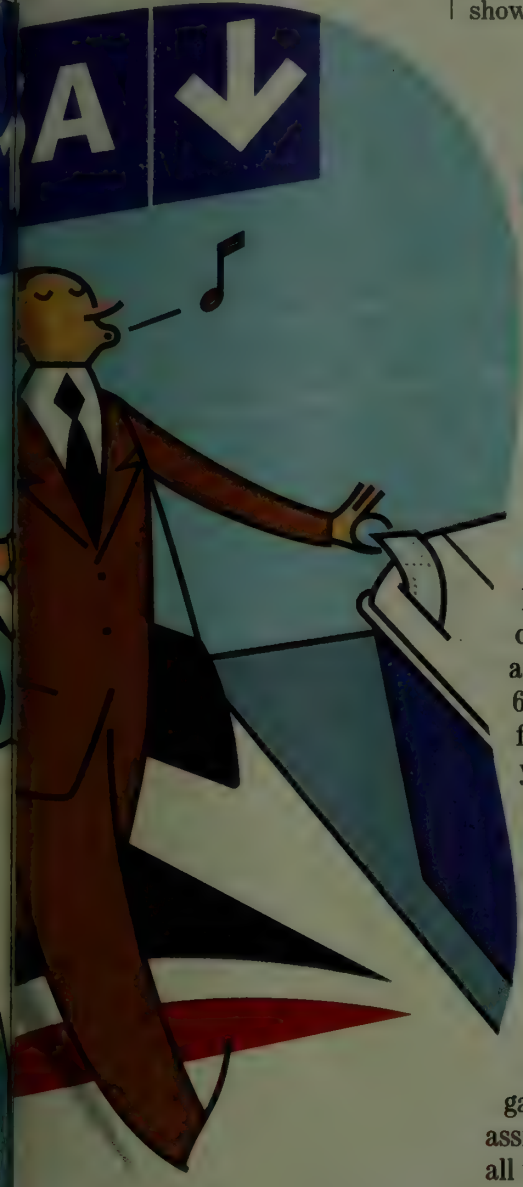
Delta is betting that technology can help it close a cost gap with discount carriers, which have been eating its biggest markets alive. The discounters enjoy costs as low as 6¢ per passenger

mile, compared with more than 10¢ Delta. On the fiercely competitive N York-to-Orlando route, Delta has s its share wither to 30%, down from four years ago, says consultant Mic Allen, chief operating officer of E Aviation Solutions.

Moreover, as the industry shakes post September 11, Delta is losing s advantages it held over other trunk

. United Airlines Inc. and US Air- Inc., having renegotiated labor con- s, will have lower costs than Delta. struggling American Airlines Inc. wrested $1.8 billion in labor conces- s. Delta, however, has fewer union- workers, giving it more leeway to ploy workers or replace them with nines. Says Jim Corridore, an air- analyst at Standard & Poor's: "Delta has a huge advantage in that only ilots are unionized."

elta's long-term survival will require e than a tech upgrade, of course. r losing $1.3 billion last year on 3 billion in revenue, Delta is deter-



ed to pare $2.5 billion in expenses shed as many as 8,000 jobs by 2005, h of it through a renegotiated pilots' n pact and reduced flight capacity. ervers believe the airline must gain wage concessions from pilots this r. "If they win this concession, then a is a very viable entity," says Fred ine, a Georgia Tech business pro- or who specializes in airlines.

So far, discount carriers seem unworried about a slimmer Delta. Upstart AirTran Airways—also based in Atlanta and flying some of the same routes—has yet to lose any business to Delta, says Robert L. Fornaro, its president and chief operating officer. He boasts that AirTran will have no trouble keeping pace: "Business is up 25% year over year, and we have heavily invested in technological innovations to continually improve passenger processing," he says.

Going high tech didn't come naturally to Delta. It has traditionally been slow to understand how technology could be harnessed to save time and money. Southwest Airlines Co., for instance, showed the advantages of online ticket processing when it launched the industry's first Web site back in 1995. Delta took another year to follow suit. Today, industrywide online tickets sales save carriers an estimated $200 million a year. By eliminating steps such as printing and mailing, an airline can process an online ticket for less than $1, vs. $6 to $8 for a paper one, according to travel consultant PhoCusWright Inc.

HIGH TECH BEFORE TAKEOFF

TICKETING

Buying tickets online eliminates an average of 14 steps in distributing and processing them. Cost: 50¢ to $1, vs. $6 to $8 for a ticket sent by mail. Delta saves the 6% travel-agent commission, and passengers can get their boarding passes online.

BAGGAGE

Decide at the last minute to check your bags or switch seats, and you can make the changes at 670 kiosks Delta has installed. A further 180 will show up by this year. So far, 14 million passengers have used one.

BOARDING

Pick up the Delta Direct phone at the airport to make flight changes. Many gates also have screens that let travelers see whether they've made the standby list. Now, 3,500 former gate and counter workers are assigned to help customers use all that technology.

Data: Company reports, PhoCusWright Inc.

But Delta was always a leader among big carriers in other types of cost containment. So when losses began mounting two years ago, the pressure increased to find new savings. With one of the industry's strongest balance sheets—holding $2.5 billion in cash as of March—Delta could afford to invest in new equipment. The tech initiative was accelerated after a survey conducted last fall showed that passengers, facing stiff security procedures, were placing a higher premium on moving quickly through an airport. "It was a 'eureka' moment," says Robert Maruster, Delta's director of airport strategies and services. "We could use technology to speed up the process and get a competitive advantage."

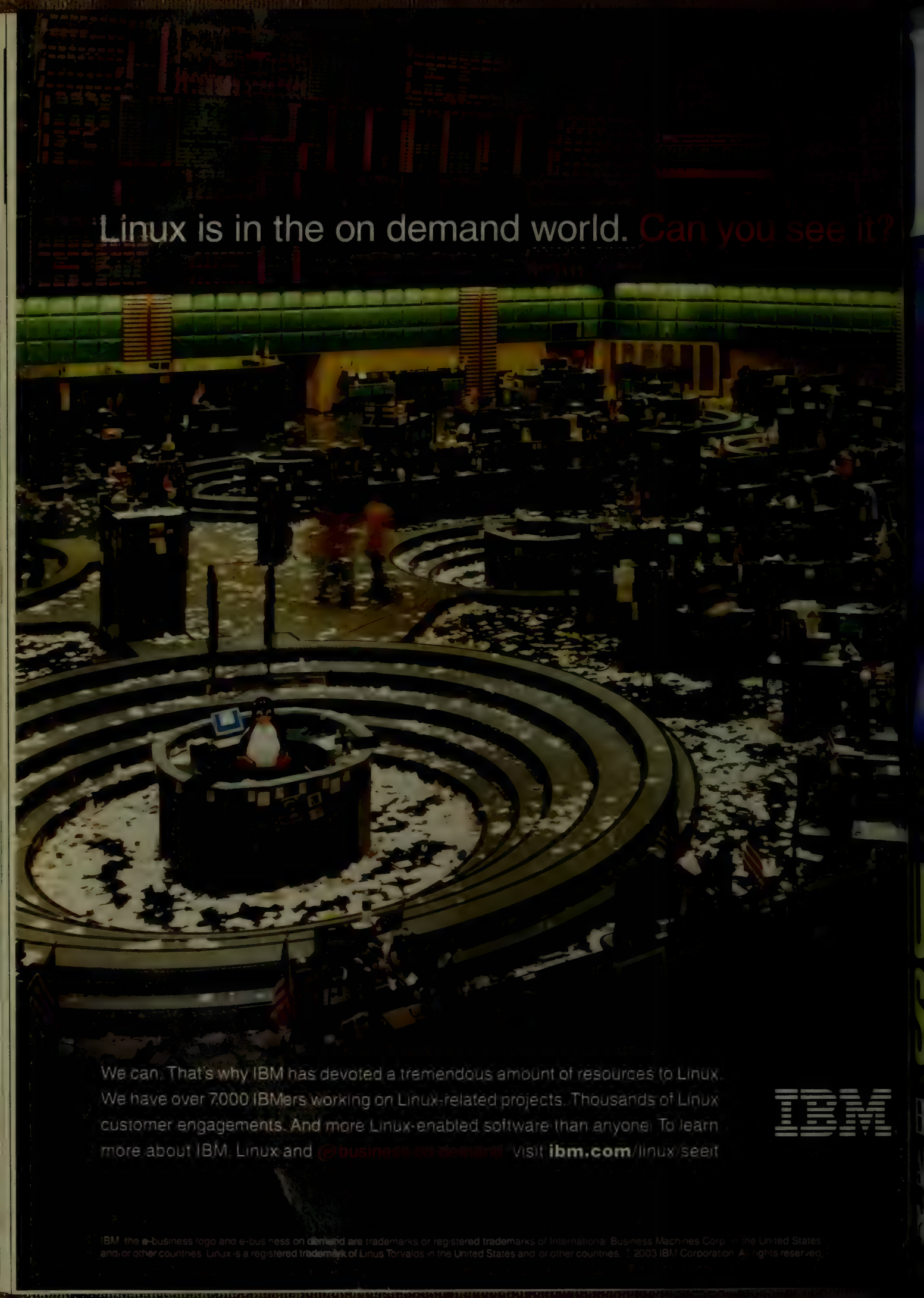
Now, it's Delta's turn to rack up a string of technological firsts. It was the first airline to let travelers use the Web to check on waiting times at ticket counters, security checkpoints, and other bottlenecks. On May 1, Delta became the first major carrier to say it would issue only electronic tickets for sales on the Web. "Delta is far ahead of everybody, and now the industry will follow its lead," says Christopher J. McGinnis, author of *The Unofficial Business Traveler's Pocket Guide.* Indeed, United and American have since both announced that they would follow Delta's lead in eliminating paper tickets online.

The company isn't worried that its automation kick, with a dearth of human contact, will leave passengers wondering why they should pay more than discount ticket prices. One way to boost customers' loyalty, Delta figures, is to redesign its major terminals around the technology—giving the self-serve kiosks plenty of space, for instance, so that passengers aren't crammed in. This year alone, Delta plans to spend $30 million to make 29 lobbies user-friendly. The plan calls for increasing the number of automated check-in kiosks, to 850, and adding 440 more Delta Direct phones by yearend.

Indications are that customers are starting to warm to it all. Delta's online sales hit $1 billion last year, making it a close second to industry leader Southwest, which had $1.2 billion. And Delta's online sales are growing much faster—35% annually, vs. Southwest's 17%. Some 14 million Delta passengers have used kiosks in the past 18 months. Says author McGinnis: "People are starting to prefer Delta's kiosks to humans—that's how user-friendly they've become."

That's good news for the passenger who's running behind schedule. In time, it may even boost customer loyalty for Delta. After years as an innovation laggard, the airline has seen the light. Now shareholders just have to hope that it can get profits aloft.

By Charles Haddad in Atlanta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Investor

2003

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Camp Rock 'N Roll

BARKER 106
A Sputtering Energy Stock

Unnecessary Surgery

Here's How to Avoid It

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THE STAT

23

CENT of 1,000 employees etirement investment e through work. Of them: from an adviser, 7% e, 37% both ways.

Employee Benefit Research Inst.

REERS

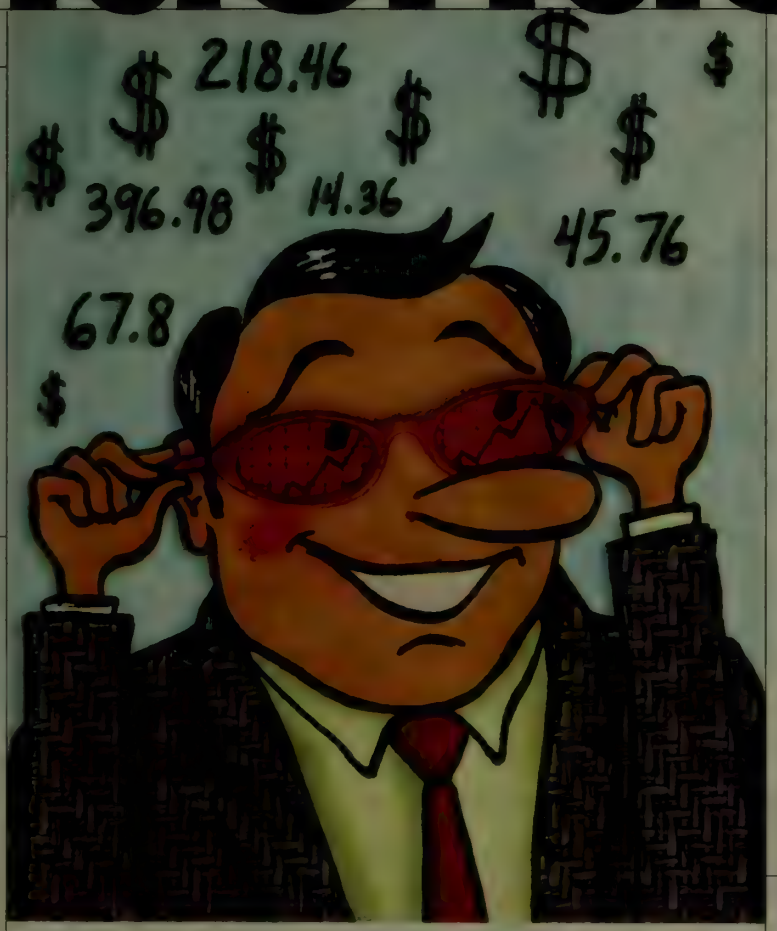
E MOMMY DDER

xpected, many full-time ing mothers with ren under 18 struggle the work/family balance. t's unexpected is that

71% don't feel they've had to sacrifice job advancement as a result of motherhood, says a recent erBuilder.com survey 94 mothers who worked ours a week. Here's e of what respondents about juggling career family.

t three to six hours work with children	55%
t one hour or less e work with children	53
ed flexible work dules	39
dissatisfied with life balance	25
work early for -related matters	20
commuted/ hared	3

Data: CareerBuilder.com



ACCOUNTING

A Rosy Outlook?

THANKS TO A REGULATORY crackdown, corporate earnings releases now rely less heavily on the pro forma numbers that critics contend present the bottom line minus "bad stuff." Although it's still perfectly legal to use pro forma results, Securities & Exchange Commission rules that took effect in March require companies to reconcile them with figures calculated according to generally accepted accounting principles (GAAP).

Moreover, in SEC filings, companies cannot give pro forma numbers greater prominence than GAAP figures. "It's very 'in' now to be in accordance with GAAP," says Charles Mulford, an accounting professor at Georgia Institute of Technology.

Still, not all companies have kicked the pro forma habit. Among them are **Netflix**, a Los Gatos (Calif.) video-rental company, and **Broadcom**, an Irvine (Calif.) communications company. In an Apr. 17 SEC filing, Netflix highlights "strong financial results for the first quarter," including non-GAAP net income of $31,000. In contrast, the filing puts its GAAP results at a $4.5 million loss. Management says it believes the non-GAAP figures provide "a more representative measure" of performance. Broadcom says the same. *Anne Tergesen*

APPLIANCES

DUELING SORBETS

She likes vanilla. He likes chocolate. Cuisinart solves that problem with its **$80 Flavor Duo Frozen Yogurt-Ice Cream & Sorbet Maker**, a dual-chamber device that lets you simultaneously churn out two different quart-size batches of homemade frozen treats. It's noisy, but you'll never fight over flavors again.

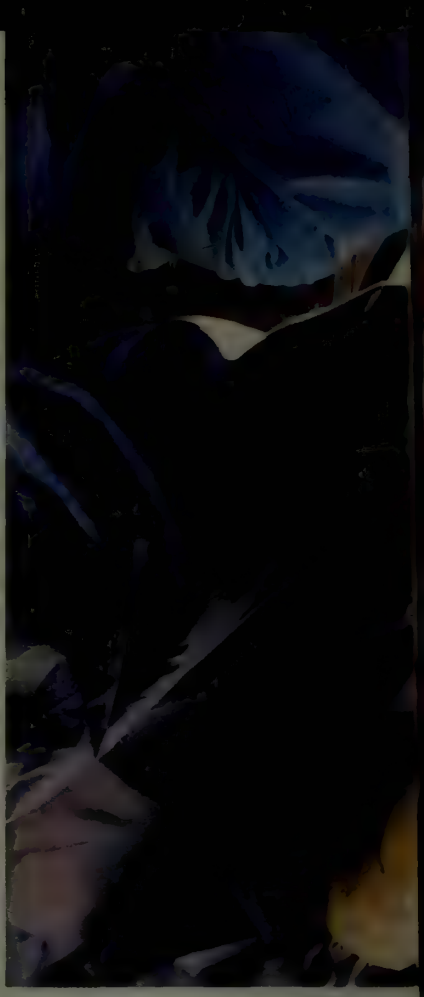
HEDGE FUNDS

HIGH-COST INDEXING

Index funds mean low-cost investing, right? Not so with the first fund to track the Standard & Poor's Hedge Fund Index. **The new Rydex Capital Partners SPhinX fund tracks the index by investing in 40 hedge funds covering nine strategies.** The minimum investment is $25,000, about a 10th of what's typically required for a hedge fund. But Rydex charges annual fees of 1.95% of assets, plus the hedge-fund annual fees, which can be 1% to 2.5% of assets. The funds also take 15% to 25% of the profits.

To Cut —Or Not to Cut?

Deciding whether a surgical operation recommended by your doctor is right for you. BY KATE MURPHY



ARE SURGEONS too quick to put patients under the knife? That's an important question for anyone considering a coronary bypass, hysterectomy, prostate removal, or a long list of other common elective operations. Studies recently released by Dartmouth College researchers show tremendous "unwarranted variations" in the numbers of invasive procedures performed in the U.S. In other words, the likelihood of your having surgery depends more on the doctor you see than whether you really need an operation.

Avoiding unnecessary surgery requires a proactive patient willing to challenge opinions and research options. "One of the biggest problems with our health-care system is that patients are way too passive," says Dr. Robert Brook, director of health policy research at the RAND Corp.

Doctors have biases that may conflict with your best interest. A urologist is more inclined to recommend surgery for prostate cancer, while a radiotherapist is likely to tell you to have radiation. An orthopedic surgeon will lean toward back surgery for disk compression, while a sports medicine doctor will more often advise physical therapy.

Not surprisingly, money often comes into the equation. "The system does not reward doctors for talking. It rewards them for doing," says Megan Cooper, editor of the Dartmouth Atlas project, which tracks health-care expenditures across the nation. Patient advocates say it's no coincidence that the most commonly performed procedures are also the most expensive. "If coronary bypass surgery cost $500, you can bet doctors wouldn't be doing so many of them," says Charles Inlander, president of the People's Medical Society, a consumer group in Allentown, Pa. A typical bypass operation runs $39,000 to $123,000, with the surgeon's fee ranging from $5,000 to $20,000.

Indeed, Gerald Hines, chairman of Hines Interests, a real estate development firm in Houston, weighed the monetary motive when he decided y ago against two cardiac surgeons' ommendations that he get a triple pass. "You have to be reflective v the cost is such a large amount, says. Besides, "I didn't want som opening up my chest." Instead, u the supervision of his internist, he lowed a strict low-fat diet, startec exercise regime, and practiced yoga meditation. He also took a beta-blo drug, which reduces the rate and f of heart contractions. That was r than 20 years ago. Now 78, Hine orchestrating his company's over expansion. "I feel great," he says.

GET MULTIPLE OPINIONS

With this in mind, never accept doctor's word that you need an i sive procedure. Be especially war it's one of the "big-ticket" operat that insurance investigators and pat advocates say are overdone (ta right). You should also check the D mouth Atlas project's Web (www.dartmouthatlas.org) to see if a procedure that is performed in y area at a rate far higher than the tional average. By clicking on "Cus Reports" and entering your state der "Community Profile Reports," can find, for example, that there suspiciously high numbers of back

es in Boise, Idaho, and of bypass eries in Redding, Calif.

et a second, third, or even fourth ion. Most insurance companies cov- nd encourage multiple consultations. doctor who takes offense that you t to seek another's advice is not y concerned for your welfare. Also, t pester your doctor into more ag- sive treatment. Be careful what you for because you'll likely get it ther you need it or not.

CATE YOURSELF

ake sure you obtain opinions from rent kinds of relevant specialists, don't go to doctors who are profes- sionally associated with the doctor you saw first. If possible, consult with doctors at the nearest teaching hospital. As academic institutions, they're at the forefront of medical research. Also, the doctors there are more often salaried rather than paid by the procedure, so they don't have a financial interest in your surgery. Since physicians are usually loath to contradict each other, give only your medical history and test results. Don't divulge your diagnosis or the treatment recommendation you already have. That way you won't prejudice the consulting doctor's judgment. "Ideally, you want to get at least three doctors in agreement on what needs to be done," says Inlander.

You also want to educate yourself about your condition so you know your options and can question your doctor intelligently. Don't rely on the ubiquitous pamphlets offered at medical offices which are essentially marketing brochures. Get on the Internet, where you can find some helpful new resources such as YourSurgery.com, which exhaustively details various procedures (table, below). For example, the site's section on carpal tunnel surgery tells you the preliminary diagnostic tests you should have. It also gives a detailed description and animated depiction of the operation. In addition to the success rate and possible complications, you'll learn that thyroid dysfunction can often cause carpal tunnel syndrome, in which case it may be resolved with medication.

Medical school libraries are another valuable resource because they can give you access to the latest research on surgical outcomes and alternatives. Many medical libraries now have consumer sections with librarians devoted to helping the general public find information. "Look at the statistics on medical errors," says Dartmouth's Cooper, alluding to a 1999 National Institutes of Health study that estimates 98,000 people admitted to hospitals die annually from medical errors. "You don't want to have surgery without exploring other options."

Most surgeries are discretionary—meaning they're at your discretion, not your doctor's. You may decide that the benefits of an invasive procedure outweigh the risks and are preferable to more conservative treatments. But it should be your informed decision. Find out what the potential complications are, and think about what's best for your body, your mind-set, and your lifestyle. The kindest cut may be no cut at all. ■

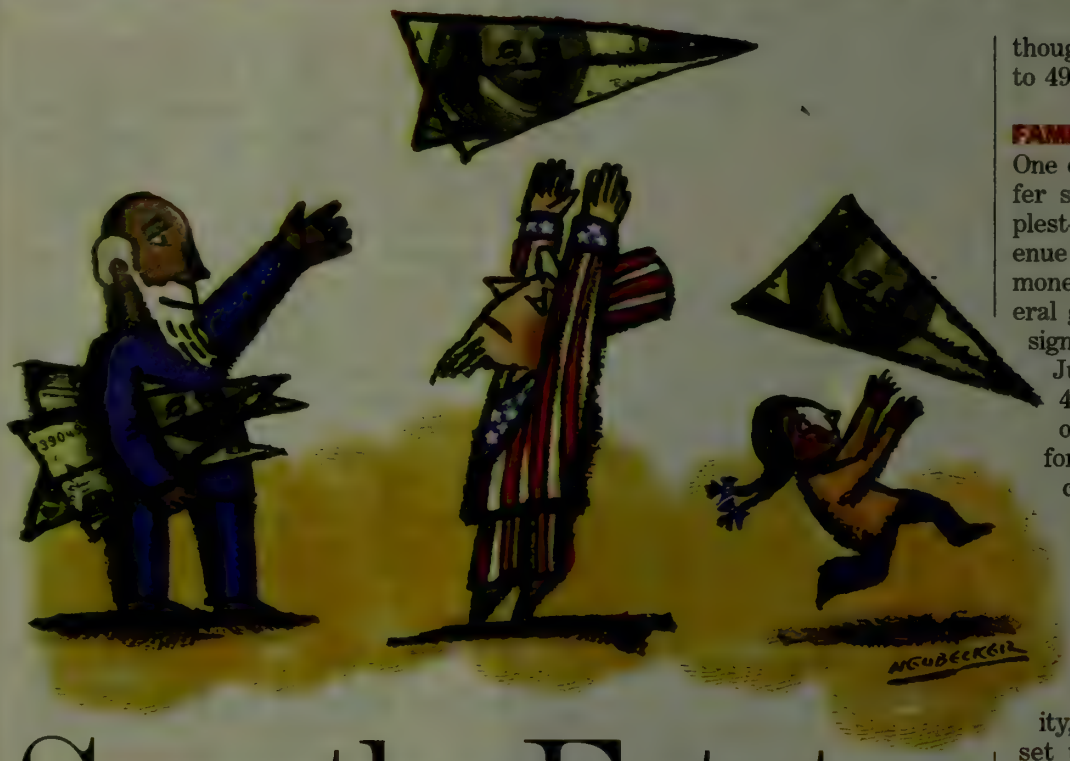
Investigate the Options

(WWW.)	DESCRIPTION
cpr.gov	Lots of consumer tips for patients, plus databases and links to ensure quality care
rtmouthatlas.org	Helps you spot any suspiciously large number of elective procedures in your region
idelines.gov	Search for the standard clinical guidelines for various procedures
edicalconsumers.org	Articles examine effectiveness of different treatments and procedures
ursurgery.com	Good descriptions of operations and diagnostic tests for $5 per report

Overdone Surgeries

- Cataract Removal
- Cesarean Section
- Coronary Artery Bypass
- Endarterectomy for Carotid Artery Disease
- Gallbladder Removal
- Hysterectomy
- Joint Replacement for Degeneration of Knee Joint
- Lower Extremity Bypass Surgery
- Mastectomy
- Prostate Surgery for Benign Prostatic Hyperplasia
- Radical Prostatectomy for Early Stage Prostate Cancer
- Surgery for Back Pain
- Surgery for Jaw Pain
- Surgery for Sleep Apnea

Data: Dartmouth College, Agency for Healthcare Research & Quality, Consumers Union, Public Citizen, RAND Corp.



Save the Estate —Tax or No Tax

Wealthy families are taking no chances. A wide range of trusts remain popular. BY ANNE TERGESEN

THE WEALTHY have always paid advisers fat sums to help them move assets from one generation to the next while minimizing Uncle Sam's cut. With the estate tax winding down over the next seven years, though, you might think these maneuvers had become passé.

Yet the alphabet soup of trusts that help the wealthy avoid inheritance taxes are hotter than ever. Why? Because of the way the estate tax phaseout was written, the tax will return in 2011 unless Congress acts to make the repeal permanent. Many Washington pols insist the tax is dead, but plenty of well-to-do families are taking no chances.

Ultralow interest rates are also making these trusts attractive. That's because many of the tax-avoidance strategies that are popular today resemble loans between family members. Because low rates allow the next generation to borrow cheaply, your heirs will be able to pay you back and pocket gains on successful investments while keeping tax bills to a minimum—if not zero.

The trust you choose depends in part on your age and health, the amount of risk and complexity you can handle, and whether you want a charity to have a cut. "I have clients doing these like there's no tomorrow," says Joanne Johnson, managing director at JPMorgan Private Bank in New York. "These are strategies that everyone should be doing."

You need a considerable amount to put into a trust—at least $100,000 for a loan and $500,000 or more for something more complex—before it makes sense to set one up, says Don Weigandt, managing director at JPMorgan Private Bank in Los Angeles. Of course, before taking that step, you and your spouse can give up to $11,000 each to a relative or friend every year before you'll owe a dime in gift tax. Plus, over your lifetime you can transfer an additional $1 million, tax-free. Give anything more than that, though, and you'll owe gift taxes o to 49% this year.

FAMILY LOAN HELD IN TRUST

One of the most attractive wealth-tr fer strategies is also one of the plest—a family loan. The Internal enue Service permits relatives to money to one another at rates the eral government sets monthly that significantly below those on bank l July's rates are between 1.23% 4.17%—the exact rate will de on your loan's maturity. The tri for the borrowers to invest the ceeds in something that e enough to pay you back and l them with a profit. Of cours the money is invested poor say, in a stock that falls by 2 your heirs will have to dig their pockets to retire their

To protect against this poss ity, you can lend the money to a t set up for your relatives. That your heirs can't be held liable f shortfall, says JPMorgan's Weigandt. to set up a trust you'll need to p lawyer $1,000 to $10,000, dependin the trust's complexity.

Moreover, to pass muster with IRS, the trust must own other as worth at least 10% of the loan's v So you'll have to donate that muc the trust and pay gift taxes of u 49% on that amount or use some o $1 million you're allowed to exe from the gift tax. That means th you want to lend your heirs $500, you'll have to put at least $550,000 a trust.

A big risk is that if your asset clines in value, the trust will hav use money you gave it to repay its c If that occurs, you won't be able to for a refund of the gift taxes you p

GRANTOR RETAINED ANNUITY TRUST (GRAT)

A GRAT is a trust that acts lik loan. As with a loan, it matures predetermined time. Moreover, any m ey you put into a GRAT will be retur to you by the time the trust expires what's in it for your heirs? All of trust's earnings—minus a percent reserved for you that's determined government interest rate—go to th free of gift and estate taxes.

Here's how it works. Consider so one who puts $1 million of stock, estate, or other assets into a GRAT earns 10% each year. So no gift t are due, the owner—say, a fathe agrees to take the entire $1 mil

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cingular
fits you best

Cingular Xpress Mail

Wireless email, secured. When you're out of the office, your data has to travel with you. But it also has to remain safe, uncompromised and secure. Xpress Mail with BlackBerry™ runs over Cingular's Mobitex and GPRS networks with plans that offer unlimited monthly usage. It fully supports both Lotus Notes and Microsoft Exchange, keeping you connected to your office. It also utilizes Triple DES Encryption, protecting even your most sensitive corporate information. To learn more about how Cingular can provide integrated business solutions that fit the voice and data needs of any size business, call 877-335-8391 or log onto www.cingular.com/business today.

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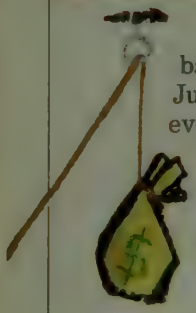
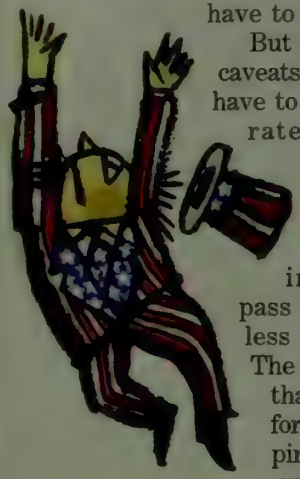
BLACKBERRY



back, plus an interest rate. In July, that rate is 3%, its lowest ever. Then, if your GRAT earns 10%, the additional seven percentage points of annual appreciation goes to your heirs tax-free when the GRAT expires.

GRATs have another advantage: If the trust falls in value, neither you nor your heirs have to cover the loss.



But there are a few caveats. Because GRATs have to pay you higher rates than short-term family loans—3%, vs. 1.23%, if you lock in a rate in July—they pass along slightly less to your heirs. The biggest risk is that if you die before your GRAT expires, your estate will owe tax on the trust's entire value, both the initial contribution and any earnings, says Douglas Moore, national director of estate and charitable planning for Citigroup Private Bank.

CHARITABLE LEAD ANNUITY TRUST (CLAT)

Similar to GRATs, these trusts can be structured to pass most of their appreciation to your heirs, free of gift and estate taxes. But whereas a GRAT returns both interest and principal to its owner, a CLAT gives everything away. Interest payments, for example, must be earmarked for charity. Principal can go to charity and heirs. Once you fund a CLAT, you can't get the money back. As a result, these trusts are most appropriate for those with a considerable net worth—say, $10 million or more, says Kevin Flatley, a lawyer and adjunct faculty member at Suffolk University Law School in Boston.

Low interest rates make CLATs attractive. That's because when rates are low, the IRS assumes your trust won't grow much. That, in turn, minimizes the amount of gift tax you'll have to pay. Say you put $5 million of stock into a CLAT and direct it to make a 5% annual payment to charity over the next 20 years. Since whatever's left in trust after 20 years of charitable tributions will go to your heirs, the levies gift tax up front on an estima what's likely to remain.

The IRS gift tax formula takes se al factors into account, including a timate of the trust's annual growth based on a government interest Because that rate is currently 3%. IRS assumes your CLAT will have t into its principal to make annual co butions to charity that are greater 3%. Of course, if the IRS assumes trust is going to eat into its principa estimate of what will remain for heirs will fall—and so will your gift bill, says Evelyn Capassakis, a par at PricewaterhouseCoopers. Eve your CLAT actually grows by 20%, y owe no additional taxes.

CLATs have one big advantage GRATs: If you die before your CLAT pires, no estate taxes are due. Tha big allure—especially if the estate returns.

BusinessWeek online

For more information on trusts, go to www.businessweek.com/magazine/extra.h

TAXES

Are Puts and Calls Hiking Your Taxes?

If you use publicly traded options to lower the risk of owning stocks, don't assume that any dividend you collect will qualify for the lower 15% maximum tax rate on dividends. With some hedging strategies, you could end up owing as much as 35% on payouts.

Although it's not stated explicitly in the tax code, **to qualify for the dividend rate, you are expected to take on some investment risk**, tax experts say. If you protect your holdings by buying put options, which can give you the right to sell a stock at a slightly lower price in the future, you've eliminated most of your downside risk, and dividends collected while the option is in place will be taxed at higher income-tax rates. **"The idea is that the government doesn't want you to earn a risk-free dividend,"** says Michael Schwartz, chief options strategist at Oppenheimer, a brokerage firm in New York.

Many people seek some downside protection by selling call options on their stocks. (When you sell a call option, you've given the buyer the right to purchase your stock at a set price, the strike price, for a predetermined amount of time, say, three months.) The cash earned on those option sales can offset some losses if the stock heads south.

But only some call options allow you to qualify the favorable tax dividend. Robert Gordon, president Twenty-First Securities, say the strike price on the call options you sell can't be more than a few dollars lower than th price that you paid for the stock Specifically, the law says that if strike price is below what you p for the stock, you must use th option closest to your purcha price. (Typically, strike prices are $2.50 apart.) So if you bought General Motors at $ you could sell calls with a $ strike price but not $32.50. Whatever strike price you use the option must be in effect for more than 30 days. With this strate you've made some additional money on the options transaction but you're still exposed to a lot of downside risk. And to get the better tax rate, that's what the IRS wants to see. *Susan Scherre*

For more details, see Twenty-First Securities' Web site, twenty-first.com.

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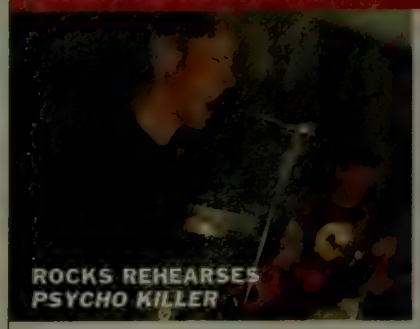
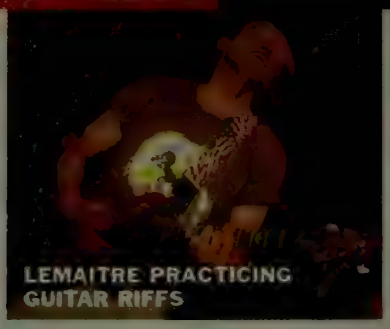

ROCKS REHEARSES *PSYCHO KILLER*

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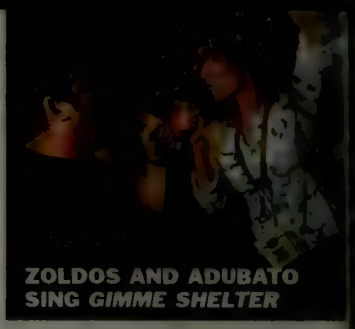

ZOLDOS AND ADUBATO SING *GIMME SHELTER*

Guitar Dreams Never Die

At Rock 'n Roll Fantasy Camp, frustrated musicians leave their day jobs behind. BY DAVID ROCKS

PERHAPS IT'S MY NAME. Ever since I was a skinny high school kid, I felt certain I was destined to be a guitar legend. Sure, I know that was a long time ago, and these days, I look a lot more like the lawn-mowing, mortgage-paying father of two from the suburbs I am than Eric Clapton or Keith Richards. But somewhere deep inside, there's a star musician just itching to get out.

So when one of my fellow editors asked for a volunteer to attend Rock 'n Roll Fantasy Camp, I jumped right up. Here was my big chance to cast off the dowdy, middle-aged life I'd been living and rub elbows with the likes of Roger Daltrey, the lead singer of The Who. This five-day blast of New York rock life was going to get me off the straight and narrow and into the deranged, debauched world of stardom that ought to be the birthright of any kid born with the last name of Rocks.

Think of it as a high-decibel version of sports fantasy camp. Taking a page from such camps, promoter David Fishof came up with the idea of giving forty- and fiftysomething lawyers, brokers, and dentists a chance to crank it up with legends (O.K., mostly minor legends) of their garage-band fantasies. The $5,950 program (rocknrollfantasycamp.com) consists of five days in New York City, jamming hearsing, and listening to rockers and moters opine on everything from heroi hair dye. The week culminates in a Batt the Bands on Sunday night. "Everybod ways asked me what it's like to hang out rock stars," says Fishof, who also man Ringo Starr's band. "I thought I could them the experience in this camp."

So it was that I found myself on a dr Wednesday afternoon in New York's ultra Hudson Hotel, guitar in hand, staring at a room of what seemed like 100 peop black t-shirts, black jeans, and black glasses. Just like in real rock 'n roll life, if you want to b a band, you have to audition. "A great player who co here and pays $6,000 doesn't deserve to be put toge with someone who can't play," says Mark Rivera, the ca music director, whose day job is playing saxophone in B Joel's band.

Looking out at the crowd, I was terrified. But with "c counselors" Liberty DeVitto—Billy Joel's drummer— bassist Jack Blades from the '80s band Night Ranger b ing me up, I figured I couldn't go wrong. I belted out Talking Heads classic *Psycho Killer*, hit most of the not needed to, and finished to cheers and applause. A half-d camp staffers slapped me on the back, saying things "You sounded great." I know they're paid to say th things, but it felt good. After all, it's a fantasy. I was pum

Then Rivera sorted the 80 campers into nine bands, ar was off to a rehearsal studio, one of many scattered aro New York's Chelsea neighborhood. My bandmates inclu guitarists Dan Lemaitre (a Merrill Lynch analyst fr Boston) and Maria Adubato, a ho maker from New Jersey whose husb had given her a trip to camp as a Our lead singer, Gary Zoldos, is v president of a $9.4 million trucking

BATTLE OF THE BANDS: Sunday night at Greenwich Village club The Bottom Line

portation company in Buffalo. hour into rehearsal, we were ing a horrific cacophony. Then in ed the Bad Boy Brass, also n as the horn section for The kees. The trio's diminutive trum- layer, Eric Biondo, heard our and shuddered. "You guys d great," he said charitably. "But e if you turned down the vol- you'd sound even better." We ed down our amps. Then we ed them down again. And again. v, start listening to each other," aid. "That's what music is all ." We started listening—and we n to sound better.

er the next four days, other stopped by to help us work up epertoire. On one occasion, Dal- visited our rehearsal room and ned in on what we were doing, never once wincing at the bad notes I managed to inject into the mix. Lunches featured chats with and short concerts by the likes of Mountain frontman Leslie West. In the evenings, pros and campers came together for onstage jam sessions.

STAR: d sport trey g with npers

On Sunday night, it was time for the big show. We all met at The Bottom Line, a Greenwich Village club, where each band played three songs. Many had cho- Who covers, and Daltrey game- ang lead vocal on every one of . "Roger, you make me nerv- Craig Langweiler, a stock bro- from Philadelphia, said to Dal- as they prepared to start ing the 1975 Who hit *Squeeze* . "Not as nervous as you make Daltrey joked back. Believe it ot, they both sounded great—as camp counselor would be sure to you. In fact, despite being ed a battle, Sunday night ended every group getting an award anything from Best Vocals to est Band. Unlike in real life, at k 'n Roll Fantasy Camp, there no bad reviews. ■

German Skill, U.S. Pizzazz

Chrysler's sporty Crossfire two-seater is about to hit the showrooms. BY CHRISTINE TIERNEY

FIVE YEARS into the transatlantic merger that produced Daimler-Chrysler, the company is finally rolling out its first genuine German-American car. Chrysler's sporty Crossfire two-seater, which goes on sale July 4, aspires to blend Chrysler's flair with precise Mercedes-Benz engineering.

It's tough to live up to that billing, but the Crossfire does. Starting at $34,495, it's arguably the most attractive car in a competitive segment that includes the Audi TT and brawny Nissan 350Z. From its long, sculpted hood to the elegant boat-tail rear, it's a lovely piece of design. When Chrysler's then-new German bosses saw the concept version in January, 2001, they insisted on producing it, although Chrysler was strapped for cash (as it is still). But Chrysler Group Chief Executive Dieter Zetsche needed a winner—and fast—to pep up the tired lineup. He wrangled a transmission, axles, and six-cylinder engine from sister brand Mercedes and commissioned German specialty carmaker Karmann Group to build the car in Osnabrueck, Germany.

The factory version of a new car often falls short of the original concept. But Karmann has skillfully mass-produced even tricky flourishes, such as the diagonal creases across the doors and side panels that reflect the name.

For all its aerodynamic glamour, the Crossfire is no road-scorching Lamborghini. With a maximum 215 horsepower, compared with the Chevrolet Corvette's 350 hp, it's more of a sporty coupe than a sports car. It offers a six-speed manual transmission for purists; there is also a $35,570 version with a five-speed automatic, featuring an autostick that lets you shift up or down without a clutch. Both handle capably.

Plush touches, such as the power-operated seats, mirrors, and door locks, and green-lit instrumentation create a snug cockpit with a premium feel. Chrysler's marketing people emphasize the silver-colored central console, with laser-etched symbols on the switches and buttons. What I liked best was the streamlined styling of the trunk: It doesn't have the bulky, silhouette-spoiling rear so prevalent these days. That reduces the trunk space, but Chrysler borrowed an idea from BMW's Mini brand and offers matching, precisely fitting luggage as standard equipment. With help from its German friends, Chrysler has rolled out a spiffy contender in the glam world of sporty cars. ■

ANADARKO ISN'T COOKING WITH GAS

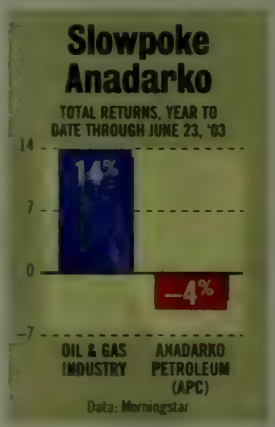
BY ROBERT BARKER rb@businessweek.com

WITH EVEN ALAN GREENSPAN wringing his hands recently on Capitol Hill over rising natural gas prices, you would expect shares of the nation's leading energy producers to be climbing, too. And they are. This year through late June, the 20 biggest oil and gas stocks returned an average of 25%. Each of them was up, every single one, except No. 13, Anadarko Petroleum. With more rigs drilling for gas in the U.S. than any other company, Anadarko shares somehow lost 4% (chart). Opportunity?

That's what I wondered as the stock kept running sideways in the mid-40s, far below a peak of nearly $76 back in late 2000. It remains stuck despite what might have been a catalyst for optimism. In March, CEO John Seitz quit, and Chairman Robert Allison Jr., who led Anadarko during a growth stretch from 1986 through 2001, replaced him. "The board was very upset with our stock price," Allison told Wall Street analysts during an Apr. 25 conference call. "A lot of pressure was put on John, and he resigned."

At 64 and the owner of 528,512 shares worth $24 million, plus options on 2.2 million more, Allison has plenty of motivation to please fellow investors. Allison's age, his hospitalization last December for heart trouble, and Anadarko's discount stock price have some investors also speculating the company will be bought out by one of the megaproducers aiming to expand their gas reserves. Could be. Yet after looking at the company a little more closely, Anadarko strikes me as a long shot to avoid.

Widespread expectations of persistently high natural gas prices present an excellent opportunity for North American producers. The challenge is not just finding more gas, but finding it cheaply. That's where Anadarko has run into trouble. Last year, its cost of finding new oil and gas jumped 23%, to $10.52 per barrel of oil equivalent, or BOE (a way of measuring crude oil and gas together). Allison knows that's far higher than Anadarko's leading rivals, such as Apache ($7.04 per BOE last year). Big outlays in any given year may take several more years to pay off—temporarily inflating annual finding costs. Just the same, talking with analysts in April,



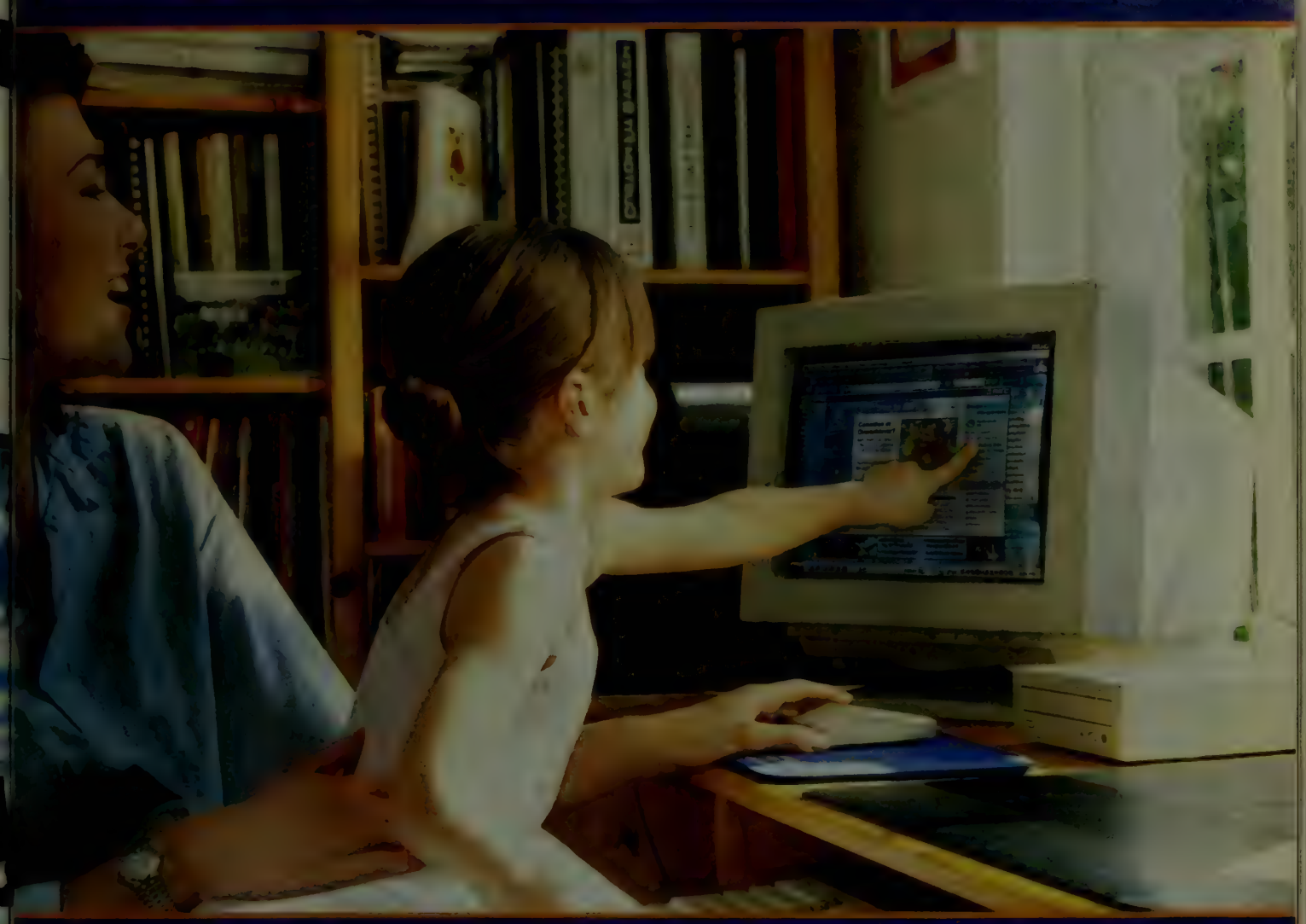
Allison set a target of $7 to $7.50 per BOE.

EXPENSIVE FIELDS: Anadarko's for finding n reserves far exceeds riva

This might be more reassuring if Allison had not been so intimately engaged in overseeing Anadarko's switch from one of the most efficient developers of energy reserves to one of the least. Before Allison left his post as CEO, Anadarko's finding costs had jumped to $8.53 per BOE in 2001, from $3.13 in 1998. Then, after Seitz became CEO in Janu 2002, it's not as if Allison went fishing. By July, he form new panel called the CEO Advisory Committee to "provide vice, guidance, and feedback" to Seitz.

Now, with Seitz gone after just 14 months on the job (ne he nor Allison responded to my requests for comment on the visory committee), Anadarko keeps disappointing investor June, it said worldwide output this year was set to slump 5% low the 200 million BOE forecast in April. It hopes to n back a bit of that shortfall via new fields it just bought from erada Hess for $225 million. Will that prove a good price? It' early to know. But Anadarko already is retreating from Alli $7 to $7.50 per BOE finding cost target. It now thinks $8 this "is very achievable," a spokeswoman told me. Anadarko also retracted its 2004 production forecast of 225 million BOE. So a giant question mark over next year.

Investors might be patient if Anadarko had a record of ating cash. For example, Apache over the past three years erated nearly $1.3 billion in free cash flow (that's cash from erations minus capital spending). In the same period, Anad ate $359 million. Over the past 10 years, Anadarko consume billion more in cash than it produced from operations. As S dard & Poor's energy analyst Tina Vital told me, "these p lems are going to take a while to iron out." Anadarko looks one of those market anomalies that the market has go just about right.



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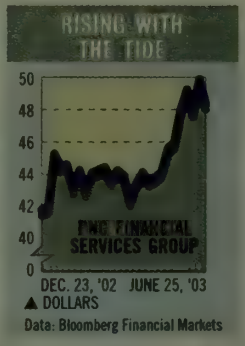
FOR BANKERS, ONE TEMPTING TARGET IS PNC FINANCIAL SERVIC
IS ORTHOLOGIC, WHICH HELPS BONES HEAL, ALSO BUYOUT BAIT
RISING PROPERTY PRICES COULD PUSH UP W HOLDING'S SHARE

BY GENE G. MARCIAL

PNC: A Sitting Duck?

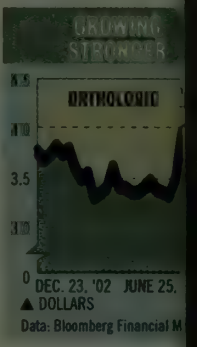
Despite the 17% rise in the shares of PNC Financial Services Group (PNC) so far this year, the company is getting a blah reaction from major Wall Street analysts. None of them rates PNC a buy. PNC earnings have been under pressure, and most analysts have cut their 2003 and 2004 estimates. Yet Dave Williams, who runs U.S. Trust's $2 billion Excelsior Value & Restructuring Fund, is buying—partly because he thinks PNC is ripe for takeover. The bank holding company, operating in Delaware, Florida, New Jersey, Ohio, and Pennsylvania, has "very attractive franchises," says Williams, despite mediocre results. A merger or sale to a larger player, he argues, would let PNC turn around faster. With assets of $68 billion, PNC is big in corporate and regional banking (including brokerage and electronic banking), real estate finance, asset management, and global mutual funds. The market's recent rise helped lift PNC to 48, up from 42 in mid-February—still way below its high of 75 two years ago. The stock trades at just twice its book value of $24 a share, notes Williams. Similar firms acquired lately fetched 2.5 to 3 times book. PNC deserves a 2.5 multiple, or $60 a share, says Williams. He thinks Bank of America, Wachovia, and Citigroup are logical suitors.



John Kline of Sandler O'Neill & Partners, who rates PNC a hold, agrees it's a good buyout bet, but he thinks PNC may want to wait until earnings turn around to get a better price. Kline has lowered his earning estimates by a nickel, to $3.80 a share in 2003 (in line with consensus), and $4.30 in 2004 (above consensus), respectively. CEO James Rohr has publicly stated that PNC plans to stay independent and pursue growth.

OrthoLogic May Get Connected To Another Bone Outfit

Orthopedics, a $14 billion industry, is chock-full of little-known investment nuggets, says Eric Miller, of Heartland Advisors, who is high on OrthoLogic (OLGC), a pure play in products that stimulate bone growth. This market is expanding at 20% a year. There has been consolidation, with major orthopedic-products maker Zimmer Holdings pursuing Switzerland's Centerpulse. OrthoLogic is also a buyout candidate, says Miller, because of its rapid revenue gro OrthoLogic, says Miller, could attract orthopedics ou that don't have bone-growth-stimulation products—such as Johnson & Johnson's DePuy (OrthoLogic's current marketing partner), Stryker, or Zimmer. He sees OrthoLogic sales growing 15% to 18% in 2003. In 2002, sales hit $40 million. OrthoLogic has yet to make money, as it's funding trials for other products—such as potential blockbuster Chrysalin. Now in Phase 3 trials, Chrysalin is an injectable drug that speeds the knitting of broken bones. Chrysalin would be a big product for any buyer, adds M who figures OrthoLogic, now trading at 4, is worth 10. alyst Justin Cable of investment firm B. Riley, who rates stock a buy, says the upside potential of Chrysalin, expe to hit the market in 2005, is "significant." Cable owns sh



Banking on Land Values in Puerto Rico

Puerto Rico's W Holding (WHI), a bank holding pany with 51 branches on the island, is a sleep sorts. Some pros think the obscure stock is wo lot more than its price of 16.48. Donald Gimb investment firm Carret, who owns shares, fig W, trading at 8.9 times his 2004 earnings estimate of $1.80 serves a p-e ratio of 20 since its earnings are growing at a 30% a year. He puts its worth at 35. One of W's unrecognized assets: its land, which is on the books at cost. W is developing some into branch locations. "Although it's impossible to determine exactly the value of the land, we estimate it's worth tens of millions of dollars more than what is carried on the books," says Audrey Snell of investment firm Brean Murray, who rates W a strong buy. She says land prices in Puerto Rico are shooting up—and estimates W's assets will grow to $10 billion in 2003 and to $12 billion in 2004 from 2002's $8.2 billion, not including the land's current v Snell sees earnings of $1.31 a share in 2003 and $1.79 in 2

BusinessWeek online Gene Marcial's Inside Wall Street is posted at nessweek.com/today.htm at 5 p.m on the ma zine's publication day, usually Thursdays. In some holiday weeks, such as July 4, t date is a Wednesday. See Gene on Fridays at 1:40 p.m. EST on CNNfn's *The Money G*

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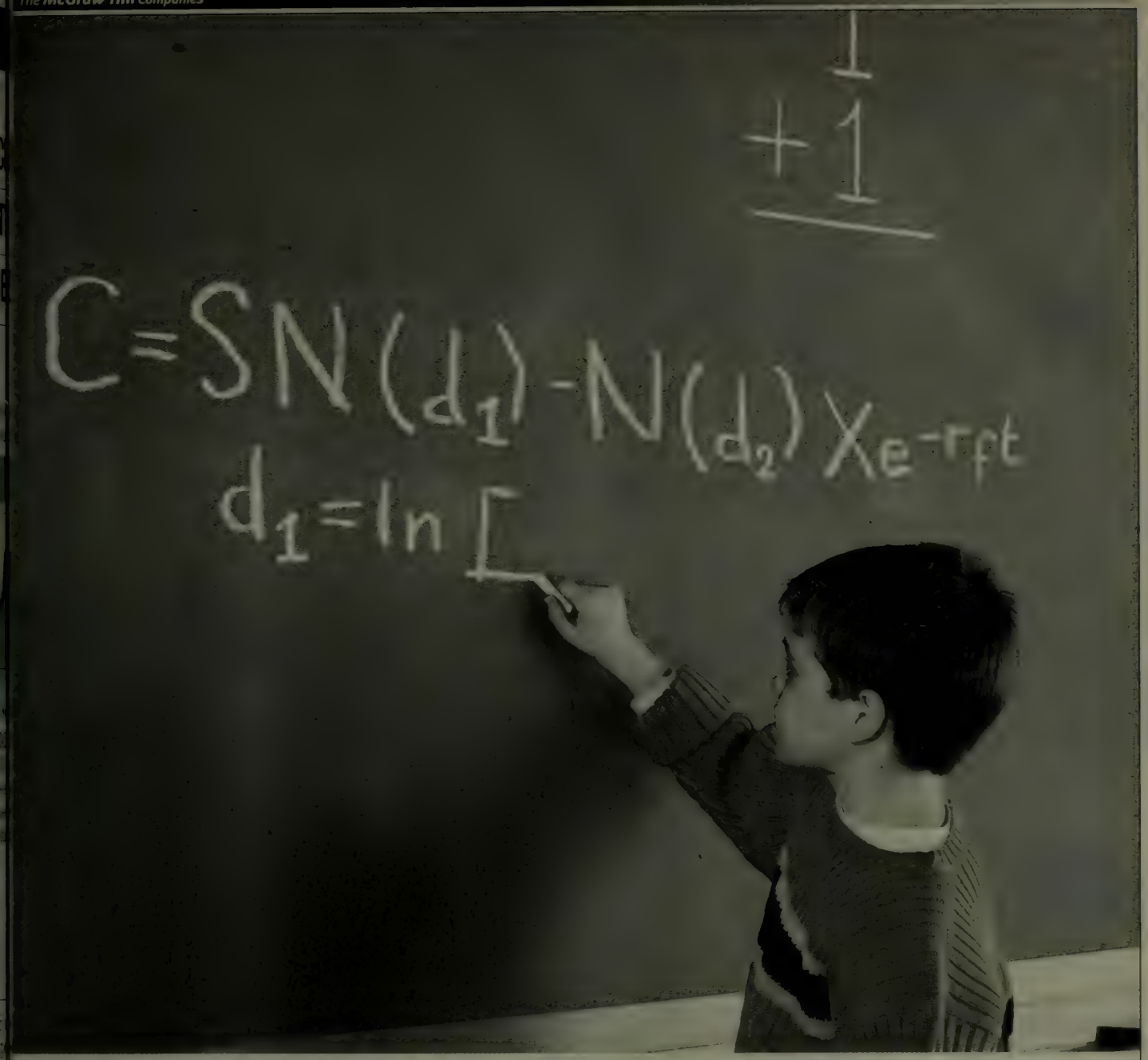

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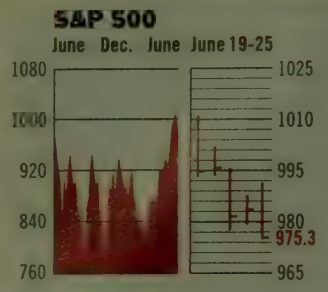
BusinessWeek Investor FIGURES OF THE WEEK

STOCKS



COMMENTARY

The bull market lost its drive the past week. The S&P 500 slipped 3.4% to its lowest level in three weeks. The Dow lost 3.0% and the Nasdaq fell 4.4%. One cause: The Federal Reserve cut interest rates only ¼% instead of the ½% some expected. A new round of earnings reports starting next week could recharge the bull—or stop it.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	JUNE 25	% CHANGE WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	975.3	–3.4	10.9	–0.1
Dow Jones Industrials	9011.5	–3.0	8.0	–1.3
NASDAQ Composite	1602.7	–4.4	20.0	12.5
S&P MidCap 400	478.9	–2.3	11.4	–0.2
S&P SmallCap 600	218.1	–2.7	10.9	–3.4
Wilshire 5000	9333.2	–3.2	11.9	0.9
SECTORS				
BusinessWeek 50*	580.7	–2.7	7.1	–5.1
BW Info Tech 100**	303.7	–3.2	6.4	3.4
S&P/BARRA Growth	495.8	–3.4	10.5	2.4
S&P/BARRA Value	476.1	–3.4	11.3	–2.6
S&P Energy	198.1	–0.8	5.2	–6.8
S&P Financials	331.7	–3.6	11.7	–0.5
S&P REIT	99.2	0.5	9.2	–3.3
S&P Transportation	174.2	–3.4	2.5	–7.5
S&P Utilities	112.4	–2.0	15.0	–7.6
GSTI Internet	118.6	–3.8	58.8	66.1
PSE Technology	559.6	–4.8	22.1	11.8

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JUNE 25	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	957.8	–3.5	13.4
London (FT-SE 100)	4067.9	–3.3	3.2
Paris (CAC 40)	3108.7	–3.3	1.5
Frankfurt (DAX)	3198.8	–3.2	10.6
Tokyo (NIKKEI 225)	8932.3	–1.8	4.1
Hong Kong (Hang Seng)	9629.0	–3.4	3.3
Toronto (S&P/TSX Composite)	6970.6	–1.9	5.4
Mexico City (IPC)	7078.4	–0.7	15.5

FUNDAMENTALS	JUNE 24	WK. AGO
S&P 500 Dividend Yield	1.65%	1.60%
S&P 500 P/E Ratio (Trailing 12 mos.)	32.0	32.3
S&P 500 P/E Ratio (Next 12 mos.)*	17.3	17.7
First Call Earnings Revision*	–0.69%	0.19%

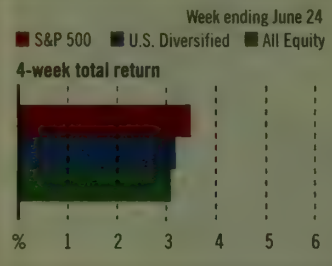
*First

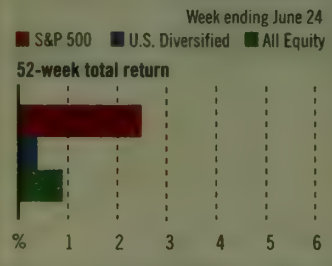
TECHNICAL INDICATORS	JUNE 24	WK. AGO
S&P 500 200-day average	891.2	888.7
Stocks above 200-day average	80.0%	84.0%
Options: Put/call ratio	0.70	0.65
Insiders: Vickers NYSE Sell/buy ratio	4.11	3.86

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Computer Stores	19.2	Internet Software	128.5
Home Entertainment	18.3	Wireless Services	85.0
Health-Care Services	14.9	Biotechnology	55.2
Restaurants	14.6	Comptr. Stge. & Perphs.	47.1
Automobiles	13.6	Office Electronics	34.4

WORST-PERFORMING GROUPS	LAST MONTH %		LAST MONTH
Photographic Products	–10.0	Tires & Rubber	–5
Health-Care Facilities	–6.5	Health-Care Facilities	–5
Metal & Glass Containers	–5.8	IT Consulting	–5
Railroads	–4.7	Multi-Utilities	–5
Oil & Gas Drilling	–4.7	Automobiles	–5

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Japan	7.1	Communications	19.0
Diversified Pacific/Asia	6.2	Health	12.8
Pacific/Asia ex-Japan	5.8	Latin America	10.8
Diversified Emerg. Mkts	5.8	Technology	9.6
LAGGARDS		LAGGARDS	
Natural Resources	–0.4	Japan	–13.6
Real Estate	–0.4	Diversified Pacific/Asia	–9.0
Precious Metals	0.4	Pacific/Asia ex-Japan	–5.7
Utilities	1.2	Foreign	–4.6

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
American Heritage	16.7	Jacob Internet	81.5
Apex Mid Cap Growth	12.6	Fidelity Adv. Lvgd. Co. A	73.0
Winslow Green Growth	11.6	Amerindo Technology D	61.1
Corbin Small Cap Value	10.9	Legg Mason Focus Trust	52.1
LAGGARDS		LAGGARDS	
Inland Rl. Est. Incm. & Gr. A	–7.5	Frontier Equity	–70.8
Rainbow	–7.3	PFunds. UltSh. OTC Inv	–52.8
Rydex Dyn. Tempest 500	–7.1	Rydex Dynam. Vent. 100	–52.8
ProFunds UltBear. Inv	–7.1	Potomac OTC/Short Inv.	–27.8

INTEREST RATES

KEY RATES	JUNE 25	WEEK AGO	YEAR
MONEY MARKET FUNDS	0.72%	0.75%	1.
90-DAY TREASURY BILLS	0.91	0.88	1.
2-YEAR TREASURY NOTES	1.29	1.24	2.
10-YEAR TREASURY NOTES	3.41	3.36	4.
30-YEAR TREASURY BONDS	4.46	4.40	5.
30-YEAR FIXED MORTGAGE†	5.24	5.29	6.

†BankRate

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR
GENERAL OBLIGATIONS	3.23%	4.
TAXABLE EQUIVALENT	4.61	6.
INSURED REVENUE BONDS	3.33	4.
TAXABLE EQUIVALENT	4.76	6.

THE WEEK AHEAD

VEHICLE SALES *Tuesday, July 1* ▶ Sales of U.S.-made and imported cars and light trucks during June probably rose to an annual pace of 16.5 million.

PURCHASING MANAGERS' INDEX *Tuesday, July 1, 10 a.m. EDT* ▶ The Institute for Supply Management's industrial-activity index for June is forecast to have improved to 50.5%, from 49.4% in May. That's according to the median forecast of economists surveyed by MMS International.

CONSTRUCTION SPENDING *Tuesday, July 1, 10 a.m. EDT* ▶ Building outlays most likely increased by 0.3% in May, reversing a 0.3% fall posted in April.

FACTORY INVENTORIES *Wednesday, July 2, 8:30 a.m. EDT* ▶ Manufacturing inventories most likely fell by 0.1% in May, the same decline posted in April.

EMPLOYMENT *Thursday, July 3, 8:30 a.m. EDT* ▶ Nonfarm payrolls in June are expected to have remained unchanged, while manufacturers probably shed another 30,000 jobs. In May, payrolls were pared by 17,000 positions, while factories cut another 53,000 jobs. The unemployment rate most likely ticked up to 6.2% and average workweek probably inched up 33.8 hours.

The BusinessWeek production index impr to 194.9 in the week ended June 14, up from a year ago. Before calculation of the 1 week moving average, the index slipped to 19

BusinessWeek online

For the BW50, more investment data, ar the components of the production index visit **www.businessweek.com**

dex to Companies

gives the starting page for a story or feature with a significant ce of a company. Most subsidiaries are indexed under their own names. es listed only in tables are not included.

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THE SUPREME COURT'S WISE DECISION

Corporate America won a big victory with the U.S. Supreme Court decision endorsing affirmative action in higher education. Indeed, it appears that the amicus briefs written by dozens of companies arguing for the concrete benefits that diversity brings to business played a significant role in persuading Supreme Court Justice Sandra Day O'Connor to throw her swing vote behind the 5-4 decision. The court also showed considerable moderation in saying that universities should ensure racial diversity by evaluating applications individually rather than resorting to quantitative measures that smacked of quota systems. This is precisely where America stands at the moment. Polls show most people feel it is right to give disadvantaged people a break, but not to automatically give them a pass by using quotas. If this appears to some to be contradictory and ambiguous, so be it. It is a pragmatic position that can work in the real world.

Globalization and the changing ethnic composition of America led most corporations to embrace diversity years ago. To understand the cultural markets in which they do business, and to communicate with customers, suppliers, and their own changing workforce, managers have implemented affirmative-action and diversity programs. The Supreme Court decision legitimizes and reinforces this action, and keeps open a key pipeline supplying qualified, well-educated minorities t ranks of U.S. companies. Even so, the decision challe managers to improve their own efforts. While the compl of Corporate America today is different than it was decades ago, there are still woefully few African Amer and Hispanics in the top tiers of most companies.

Corporate America clearly has a stake in a Sup Court that is pragmatically, not ideologically, conserv (page 28). Legal fundamentalists on the court have often ed against important business interests. They voted ag federal preemption of state laws and, had they wo could have balkanized America's single, huge market. S constructionalists also tend to see spam as free speech are prone to oppose any curbs on it. They would also to disallow federal ceilings on punitive damages and tort reform.

Two Supreme Court justices who just voted to a racial diversity in America may soon be stepping down placing the 73-year-old Justice O'Connor and the 83-yea Justice John Paul Stevens with pragmatists rather than ologues is in the interest of Corporate America. An President, who himself was a businessman, should take t interests seriously.

GREENSPAN'S DELICATE GAME

Did the Federal Reserve really need to cut interest rates for the 13th time since 2001 by another 25 basis points? Probably not. The economy is showing signs of improving, with the stock market up sharply, consumer confidence rising, corporate profits trending higher, and the geopolitical situation growing more stable. With fiscal policy incredibly loose, the dollar weak, and short-term interest rates already down to 45-year lows, normal economic conditions do not call for any more cuts.

To his credit, Federal Reserve Chairman Alan Greenspan worries that we might not be living in normal economic times. He believes that the hoary beast, deflation, which has paralyzed Japan for over a decade, may be threatening American prosperity. Deflation scares him because the U.S. has very little experience in fighting it. So he is trying to prevent deflation from taking root in the first place by taking out some insurance via lower interest rates. More important, Greenspan is jawboning the bond market into believing that the specter of deflation will stop the Fed from tightening monetary policy anytime soon. In effect, he is using a policy of talking interest rates lower and keeping them down. And it's working.

The danger is that Greenspan's strategy is feeding a bond bubble that could pop and hurt the recovery (page 33). And by continuously warning about deflation and promising to keep rates low for the foreseeable future, Greenspan may be painting himself into a corner. The bond markets ex ever more rate cuts, and he has to comply or risk burs the bubble. It's a dicey game. In its most recent rate cu nouncement, the Fed again kept the door open for r easing by saying that deflation continues to worry it r than inflation.

The problem is that there aren't that many bullets le the Fed's arsenal to deal with the problem. Its short-t rates are already down to 1%, and they can only be cu zero. Talk of following an unconventional strategy to long-term Treasuries in order to lower interest rates faded. Recent research by the Federal Reserve's own showed that this unusual maneuver would be much r difficult than previously thought—and might not work that well in the end.

The hope, of course, is for Greenspan's policy of taking extra monetary insurance to work. The goal is for sha lower interest rates to keep consumer buying high and ger, at long last, new capital spending and investment reluctant corporate CEOs. That, in turn, buoys the morib manufacturing industry, puts new life into the service se and begins to bring down the unemployment rate Greenspan's strategy doesn't work, if a bond bubble deve or if the economy doesn't respond despite all the stim then the U.S. faces real trouble.

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STEALING HOLLYWOOD

Can the movie biz avoid the piracy that has crippled the music industry?

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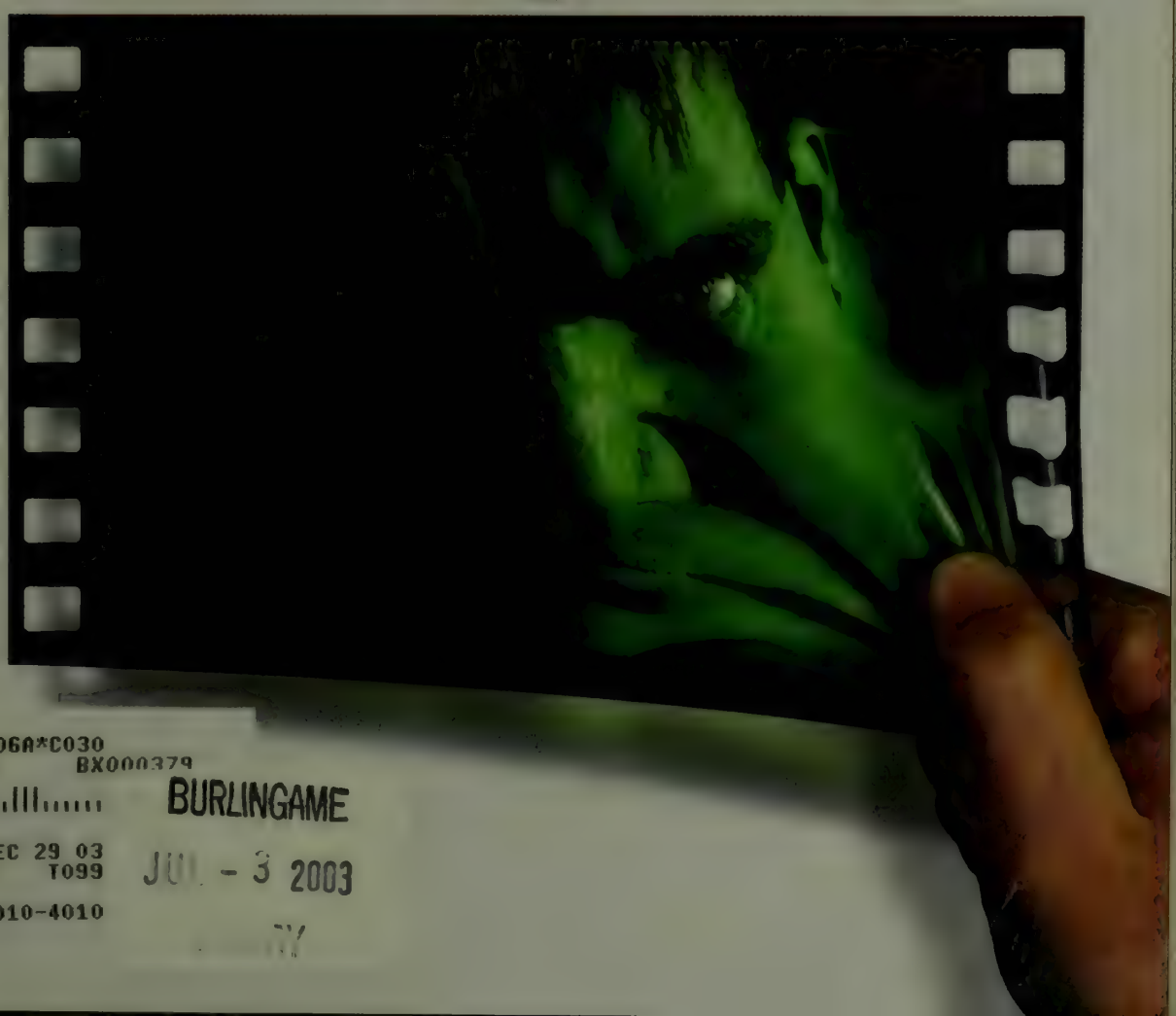

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COVER STORY

HOLLYWOOD HEIST

Counterfeit DVDs of new movies like *Charlie's Angels: Full Throttle* cost pirates 62¢ to make. They sell them for up to $15

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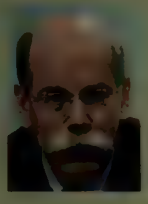

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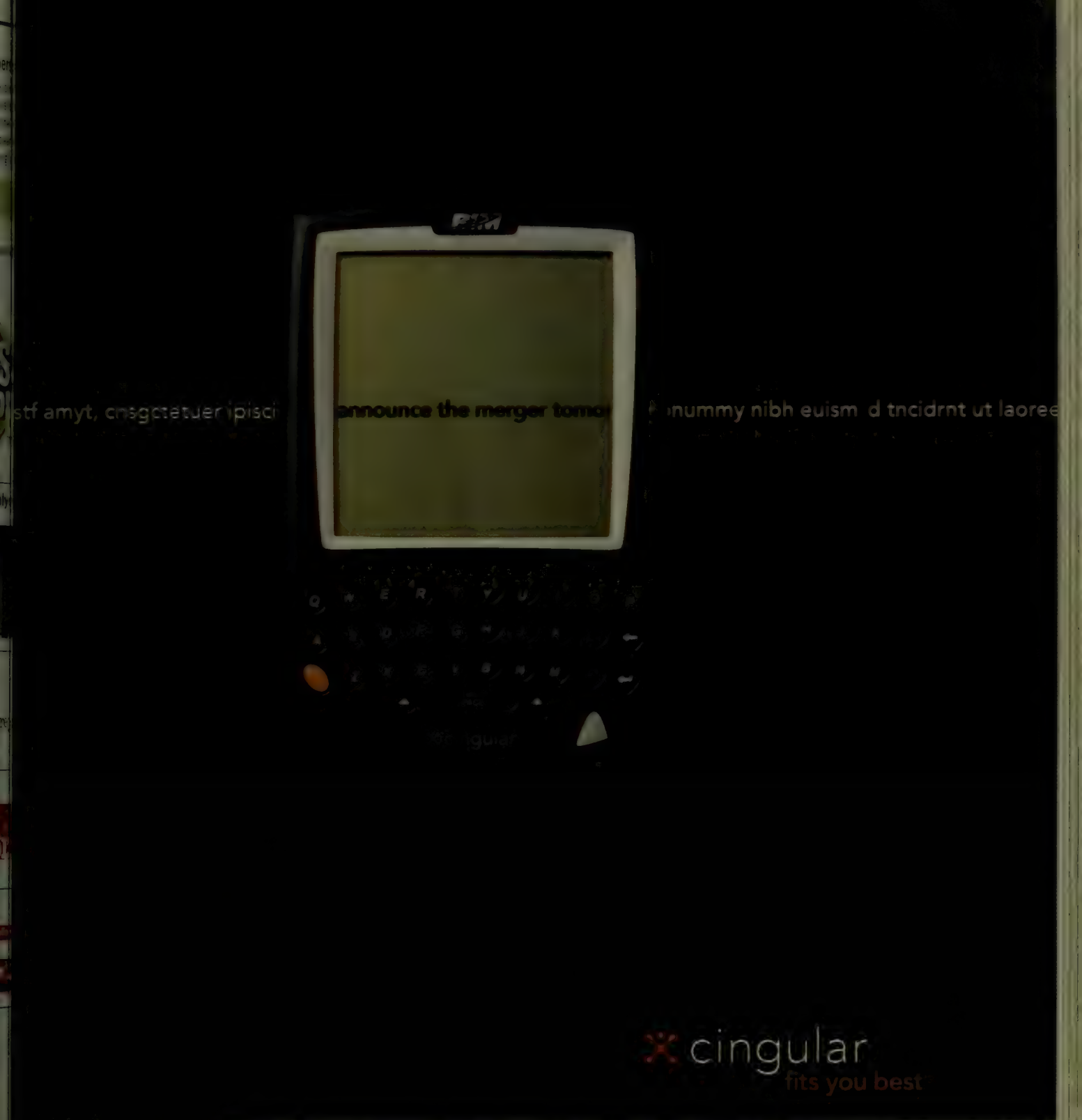

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BLACKBERRY

Up Front

EDITED BY KIMBERLY WEISUL

TALK SHOW "Plaintiffs brought their own losses upon themselves when they knowingly spun an extremely high-r high-stakes wheel of fortune."

—U.S. District Judge Milton Pollack, dismissing a suit against Merrill Lynch and former analyst Henry Blodget

STREET NEWS

REGULATOR, FINE THYSELF

THE NATIONAL ASSOCIATION OF Securities Dealers, the self-regulatory organization for brokerages as well as for the NASDAQ stock market, has been busy fining Wall Street firms and issuing new rules. So maybe that's why it took the NASD more than six months to notice that it had violated a Securities & Exchange Commission rule requiring disclosure of insider stock sales.

The infractions occurred in late 2002, after four NASD member firms exercised nearly 21,000 warrants for shares of NASDAQ common stock.

TIED UP? *The NASD filed late*

Under SEC rules then in effect, NASD should have reported three August insider sales on Form 4 by Sept. 10. Under the Sarbanes-Oxley Act, the NASD had two days to report an Oct. 15 exercise. Instead, it filed a single form on Apr. 1 covering all four transactions. A NASD spokeswoman said the late filing "was inadvertent," and may have been brought about by a change of stock record keepers. An SEC spokesman declined comment.

The NASD is in good company: Form 4 is the same one that George W. Bush filed 34 weeks late after the 1990 sale of his shares in Harken Energy. *Paula Dwyer*

AIRLINES

GODZILLA VS. THE TRAVEL SLUMP

BETWEEN SARS AND the war in Iraq, international travel has been hard hit. Japan Airlines, in an effort to get its countrymen flying again, has enlisted a powerful ally: Godzilla.

HERO: *Matsui*

During the baseball season, JAL is running a tour just for fans of New York Yankee Hideki "Godzilla" Matsui, known for the mammoth home runs he hit in his native Japan. For $817, fans get airfare from Tokyo to New York, three nights' hotel lodging, a ticket to a Yankees game, and a Matsui T-shirt. The Tokyo-based travel agency H.I.S. runs a similar tour for $668. "It's hard to explain Matsui's popularity to someone who hasn't witnessed it," says JAL spokeswoman Carol Anderson. "It's crazy." The Matsui package is the most popular of JAL's U.S. tours.

Godzilla watchers who want to stay in Japan can still indulge in Matsui mania. In June, JAL debuted a special 747 to fly between Matsui's hometown of Komatsu and Tokyo, and between Tokyo and Sapporo. It's adorned with a 30-foot-high head shot of Matsui. JAL partner Japan Air System will unveil a similarly decorated Airbus A300 on July 18.

So far, Matsui has disappointed neither fans nor Yankees. As of June 30, he was batting .304 and was second on the team in RBIs. The Yanks were in first. *Skip Rozin*

MAD AVE

COMING SOON: MO BIG-SCREEN ADS

MOVIEGOERS MAY SAY T love to hate them, but t ads on the big screen— ones that come before trailers—aren't going a anytime soon. Last year, cinema-ad market top $200 million, up 30% over year, says Chuck Bat president of National Cin Network, a unit of AMC tertainment that sells the "There are still some thea

with [ad-free] screens, those are few and far tween," he says.

They're likely to bec even scarcer. Theater own formed the Cinema Adve ing Council in February promote the industry standardize practices for ing ads. They're armed new Arbitron research sh ing that moviegoers don' ally mind the ads. Two-th of survey participants, 70% of those aged 12 to said the commercials di bother them. Plus, 8 in moviegoers actually rem ber the promos after the ends. So movie ads typic command a 50% premi over those on TV, when m ured by the cost of reach a thousand viewers.

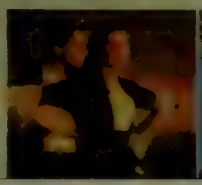
For the minority who resent Madison Avenue's ay into theaters, there's h The commercials usually less than five minutes in tal, because moviegoers t to tune out after the first minutes. *Chester Dau*

THE LIST

THE BUBBLE LIVES ON

CEO compensation doesn't hold a candle to that of the best-paid hedge-fund managers. Here are the top-earning managers of 2002, what they made, and a little perspective:

MANAGER/FUND	BRUCE KOVNER Caxton Associates	JAMES SIMONS Renaissance Technologies	PAUL TUDOR JONES II Tudor Investment	KEN GRIFFIN Citadel Investment	STANLEY DRUCKENMILLER Duquesne Capital
COMPENSATION	$600 million	$287 million	$250 million	$225 million	$175 million
THAT'S ABOUT EQUAL TO...	Gross domestic box-office receipts for *Titanic*	Marketing budget for the current MSN campaign	Incentive offered to Boeing to build a plant in California	Mick Jagger's estimated net worth	George W. Bush's projected reelection war chest



Data: *Institutional Investor, BusinessWeek*

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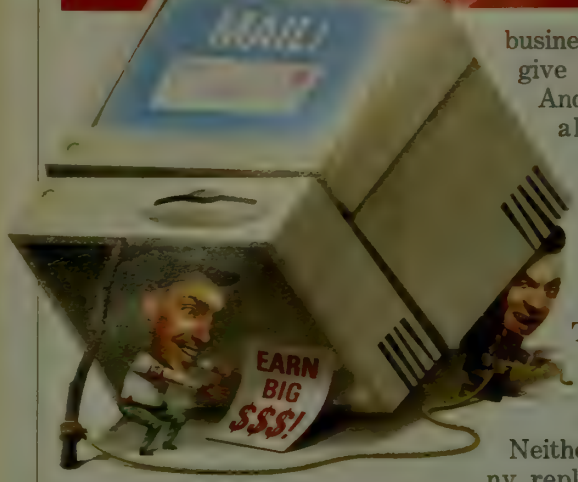
Up Front



businesses don't easily give to third parties. And FedEx and UPS already handle tracking and refunds. Says UPS spokesman Norman Black: "This is truly a consumer scam." The Federal Trade Commission won't say if it's investigating. Neither refund company replied to repeated calls and e-mail.

FUNNY BUSINESS

DON'T TRY THIS AT HOME

IT SOUNDS TOO GOOD TO BE true—and it is. Spammers such as FedEx-UPS Refund Recovery and Refund Recovery Software say you can earn $75 an hour working from home. Just buy a $77 software program to track the on-time status of packages, then earn fees helping companies collect refunds for late delivery.

But this would require detailed account info, which

Earlier this year, FedEx and UPS hit another company that's operating similarly, Overnight Recovery Software, with cease-and-desist orders. Founder Thomas Liantonio won't say how many customers he has or if they've started businesses. He admits his marketing leaves out vital information. "Is it legitimate? It falls in a sort of gray area," he says. He intends to fight the cease-and-desist orders. As for the riches to be made, consumers can expect late delivery. *Brian Grow*

RETAIL DETAIL

MALLS: NOW MORE LIKE DOWNTOWN

HUGE ENCLOSED MALLS SUCH as the Sherman Oaks Galleria in the San Fernando Valley were once more than mere shopping centers. In movies such as *Fast Times at Ridgemont High*, the mall was where the action was. Now, an estimated 140 large malls are failing. One solution: Remake them as outdoor shopping plazas, reminiscent of the town centers they replaced.

REVAMPED: *Galleria*

Dozens of projects are under way. At Sherman Oaks, both the roof and the massive parking lots are gone. A former Robinsons-May department store now hosts Warner Bros. Animation Studios. Denver's Villa Italia mall is being reborn as Belmar, with equal parts retail and office space, plus 1,300 residences. Kingsdale Shopping Center in Upper Arlington, Ohio, located near Columbus, is also slated to be rebuilt.

Retailers say on-street sites allow more distinctive storefronts. In a successful redevelopment, says Barnes & Noble chairman Leonard Riggio, "the entire center becomes a destination, and your store becomes part of that." Just what retailers wanted when they signed on with the *über*-malls of yore. *Gerry Khermouch*

DRAWN & QUARTERED

SECOND LIVES

DUSTING COBWEBS OFF A WEB STAPLE

PLENTY HAS BEEN WRITTEN about Napster, the online music pioneer with technology that refuses to die. But it's not the only former Internet high-flier with nine lives. Remember PointCast? It automatically scooped information off the Web and delivered it to your PC's screen saver.

EARLY ON: *PointCast founder Hassett*

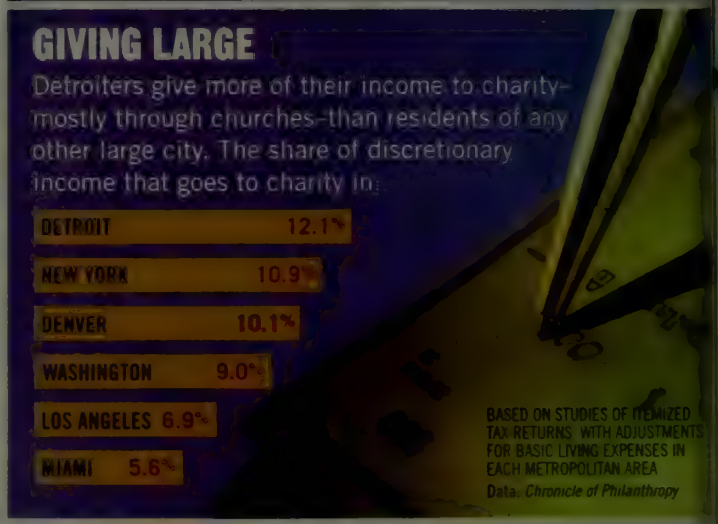
Now, that same technology is being tested for use in AOL Time Warner's Communicator e-mail software, with familiar features such as a screen saver and a ticker with data ranging from stock quotes to sports scores. "Anyone who remembers PointCast would look at this and say: 'Wow,' " says former Infogate CEO Christford Boro, whose company once owned PointCast.

It has been quite a ride. In 1997, PointCast boasted 1.5 million users, had raised $48 million, and was sitting on a $450 million buyout offer from News Corp. But PointCast was too early. Broadband connections were rare, and users grumbled that PointCast was too slow. In 1999, Infogate bought PointCast for just $7 million. Infogate fixed PointCast's code, making it faster and leaner, then quietly sold the technology and patents to AOL in March. PointCast's time may finally have come. *Linda Himelstein*

THE BIG PICTURE

GIVING LARGE

Detroiters give more of their income to charity—mostly through churches—than residents of any other large city. The share of discretionary income that goes to charity in:



Polls, surveys, and other items for consideration in this section should be sent to **upfront@businessweek.com**

Ricoh handles every color of the rainbow. But we're especially partial to green.

Naturally, a global leader in digital office equipment knows a thing or two about color. Why the predilection for green? Because "green" concepts–conserving and recycling resources, conserving energy and preventing pollution–are close to our hearts. And more and more people today feel the same way.

Even hard-headed business types are acquiring a soft spot for sustainable practices. After all, what's good for the earth is good for the bottom line as consumers reward companies with responsible policies and innovative solutions. A classic win-win situation.

At Ricoh, profitability and sustainability go hand in hand. Our eco-minded efforts include technologies to improve energy efficiency and reduce climate-warming emissions; production processes designed to result in zero waste to landfills; recyclable, energy-efficient products; a green suppliers pipeline; and a global environmental management system.

We've already spun our green policies into another color: gold. The World Environment Center (WEC) awarded Ricoh its 2003 Gold Medal for International Corporate Achievement in Sustainable Development.

Now we want to share the ways to make the world a greener place.

One Gold Medal is awarded each year by the WEC, a U.S.-based non-profit organization.

How well do you share?

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Readers Report

WHY NOT STUDY BARKING DOGS INSTEAD?

The occasions of natural extremely low frequency (ELF) signals have random, time-of-day, and seasonal characteristics that have, on occasion, been falsely tagged (as have barking dogs) as precursors to such phenomena as floods, droughts, infestations of grasshoppers, and earthquakes ("Spotting quakes hours before the shaking starts," Developments to Watch, June 23). There is no scientific reason to believe—and no reproducible evidence—that the ELF signals recorded hours before the California earthquake are other than a random event. The future program discussed in your article is most assuredly a waste of funds that could have been better spent on topics of earthquake mitigation.

Wallace H. Campbell
National Geophysical Data Center
Solar Terrestrial Physics Div.
Boulder, Colo.

WOMEN GET MORE OUT OF A COLLEGE DEGREE

While 54% of all college students are women, this is because 62% of college students over age 35 are women ("The new gender gap," Cover Story, May 26). Women earn relatively more than do men by pursuing education. According to U.S. Census Bureau data, a woman working in 1997 in the "sales" occupation category that requires no college degree earned $10,600, while a man in the same field earned $27,600. A woman with a college degree working in a "professional specialty" occupation earned nearly $30,000 in 1997, and a man $46,000. A woman would have increased her income by 183% by obtaining a college degree, but a man's income rises by only 70%.

This is why my three daughters will be pursuing a college and/or post-secondary degree. It is still a man's world... a girl's best friend is her college degree

John Ree
Arlington,

CORRECTIONS & CLARIFICATIONS

"Can Motown get out of this funk?" (News Analysis & Commentary, June 23) mischaracterized Standard & Poor's outlook for two auto companies. This spring S&P revised its ratings outlook on General Motors Corp. and DaimlerChrysler to negative. However, it did not place either company on negative CreditWatch.

BROADENED BY GOING ABROAD

In 1969, a skinny kid from North California traveled to Sweden to spend a year abroad, living with a family and attending high school ("From Sweden with love," BusinessWeek Investor, June 4). AFS Intercultural Programs made it possible for me to have an unforgettable experience, and 34 years later, the lessons are still with me. The friendship with the Ostberg family endures. Each year when the Nobel Prize winners are announced, I remember the winners from my year because we AFSers were there to see the awards presented. Thanks for your article on an incredible program.

David Grav
Napa, Ca

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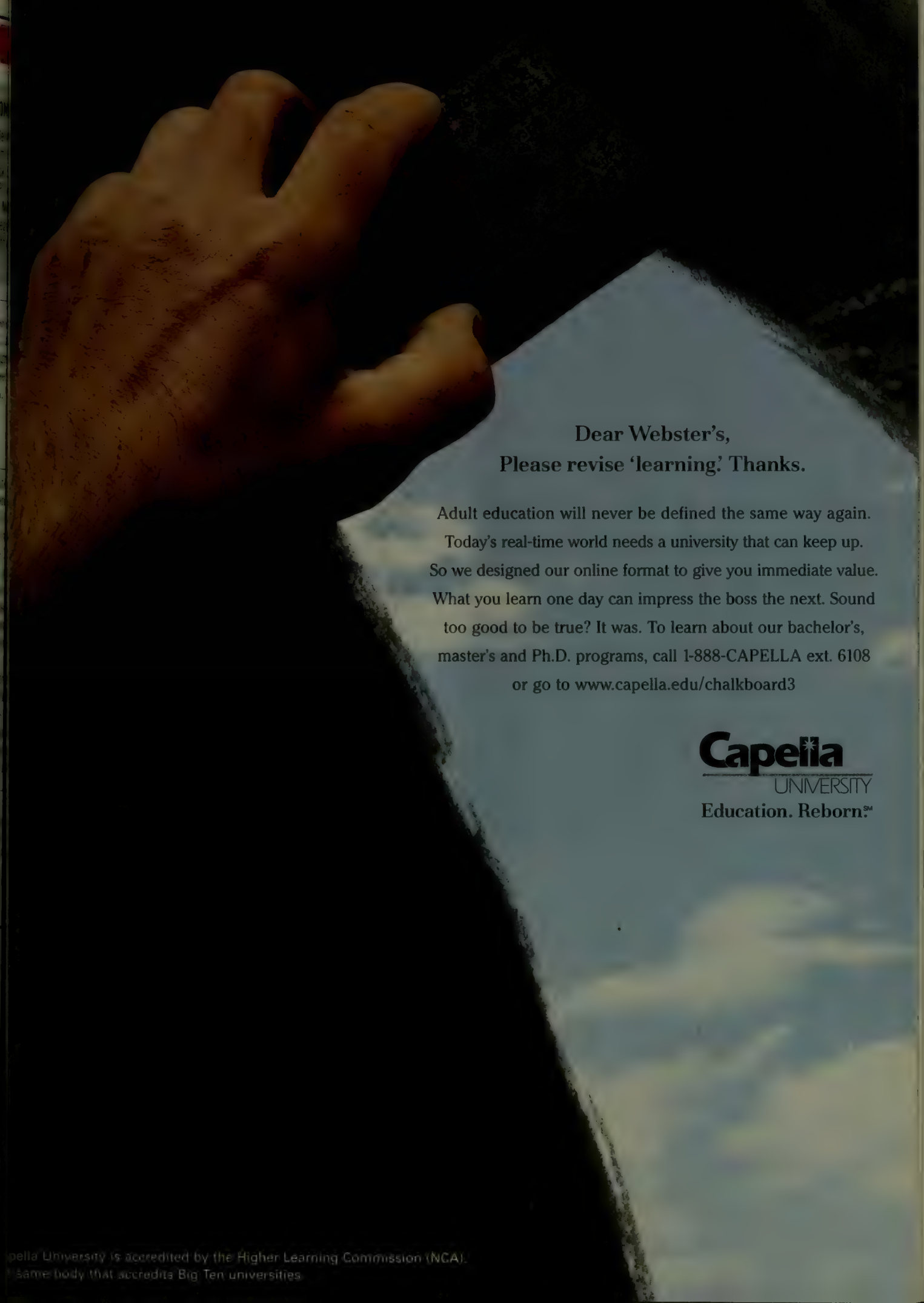
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CLOUD THE ISSUE

PROFITS & PRINCIP

The issue of global warming has given rise to heated debate. Is the burning of fossil fuels and increased concentration of carbon dioxide in the air a serious threat or just a lot of hot air?

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OR CLEAR THE AIR?

Shell believes that action needs to be taken now, both by companies and their customers. We are actively managing greenhouse gas emissions in our worldwide operations such that by 2010 they are still 5% or more below 1990 levels, even while we grow our business. We are also working to increase the supply of natural gas, a cleaner option for electricity generation and home heating, and offering alternative energy sources such as solar, hydrogen and wind power. It's all part of our commitment to contribute to sustainable development, balancing economic progress with environmental care and social responsibility. Solutions for the future won't come easily, particularly in today's climate, but you can't find them if you don't keep looking.

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STEALING TIME
Steve Case, Jerry Levin, and the Collapse of AOL Time Warner
By Alec Klein
Simon & Schuster • 336pp • $25.95

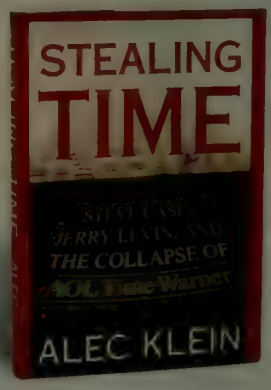
MERGER OF TITANS, CLASH OF CULTURES

In late 2000, as the merger between America Online and Time Warner Inc. was nearing completion, AOL Senior Vice-President Neil Davis and three Time Warner executives met with Hasbro Inc. CEO Alan Hassenfeld to discuss online advertising. Davis warned Hassenfeld that if Hasbro failed to sign an AOL ad deal, it was ceding the opportunity to its flagging rival Mattel Inc. Abruptly plunging his steak knife into the table, Davis declared: "What we like to do to a competitor that is damaged is drive the knife in their heart." The Time Warnerites, representatives of a more button-downed corporate culture, were horrified and incensed. In the end, Hasbro decided against advertising on AOL.

Such stories abound in Alec Klein's *Stealing Time: Steve Case, Jerry Levin, and the Collapse of AOL Time Warner.* This engaging account of the ill-fated 2001 merger of AOL and Time Warner—the first of four books on the topic being published this year—is at its best when depicting the antics of AOL's high-living, gunslinging dealmakers. After all, the author is the *Washington Post* reporter who last July broke the story about questionable AOL advertising deals that sparked an ongoing Securities & Exchange Commission investigation. But despite the colorful tales, Klein's book does not deliver much that's fresh—not even on the SEC accounting inquiry. The author also fails to consider larger questions about the colossal stumbles in what was once billed as a transforming merger of the world's biggest online service with the Old Media giant.

Stealing Time gets off to a slow start, as Klein wends through the details of AOL's founding and the regulatory approvals needed for the merger. But the narrative picks up speed about halfway through, when Klein begins exploring the business practices of AOL chief dealmaker David M. Colburn, who was ousted last summer during the accounting scandal.

Colburn, who Klein says affected a grizzled, rumpled "I-don't-care-what-the-hell-you-think manner of dress," came to be feared in the dot-com world as a take-no-prisoners negotiator. He extracted onerous terms from fledgling Web startups, who felt they had to advertise on AOL if they were to have any credibility on Wall Street. Klein describes how, fat on these easy pickings, Colburn's gang whooped it up—jetting to topless bars in San Francisco for ostensible team-building exercises and snorting cocaine in the open during a post-football-game traffic jam. It was an unapologetic macho culture, but, Klein observes, some employees justified it, saying it had "a socializing effect, a way of bonding AOLers, like the little mischievous boys of *The Lord of the Flies.*"



When the dot-coms imploded not long after the AOL-Time Warner merger was announced in January, 2000, Colburn's team became even more aggressive. (In fact, an ad-revenue drop-off was already evident in late 1999, according to internal company documents, leading to the unusual deals that Klein first reported last summer.) In one instance, AOL agreed to purchase $250 million in computer hardware from Sun Microsystems Inc.—provided Sun bought $37.5 million in ads. In reality, Sun paid nothing for the advertising, instead giving AOL a credit for computer equipment. But AOL booked the $37.5 million as revenue. "It was fake money," Klein quotes an AOL official as saying. This case, it should be noted, has been widely cited, and no previously unreported ad deals are described in *Stealing Time.*

Klein is effective, however, in dep
ing the culture clash between the a
gant AOLers and staid Time Warner
that ultimately rocked the merger. It
that AOL executives saw as forging
ergies were repeatedly shot down
the Time Warner side, which seem
intent on demonstrating that it had
own way of doing things. What ab
using a set-top-box vendor who wa
prospective AOL advertiser? No,
the Time Warner people; they had t
own source. What about delivering
company's movies online? Time War
said it was already working on that
its own.

The oil-and-water mismatch betw
the companies played out in the cor
suites, too. Klein has little inside d
on what took place—perhaps beca
his sources were mainly middle m
agers—but he does reco
the dramatic and rapid
raveling of the compan
top management. Recrim
tions were common as
Time Warner's outlook d
riorated in the soft econo
Chairman Stephen
Case—along with Vice-Ch
man Ted Turner—wanted
oust CEO Gerald M. Levin
particular point of frict
was Levin's bid for AT
cable unit, made without
involvement of Case, who opposed
move. Levin's December, 2001, resig
tion set off a chain reaction. Chief
erating Officer Robert W. Pittman, c
the heir apparent, resigned after his
COO, Richard D. Parsons, was nam
CEO. Then, pressured by unhap
shareholders, Case resigned in 2003

Corporate theatrics of this scale
for more analysis than Klein gives u
leaving room for the forthcoming bo
to pick up the slack. Was the mer
folly to begin with? Did it fail just
cause it was mismanaged? Or was
the ultimate dot-com con? Surely, t
bungled marriage of gargantuan cor
rate egos—against the powerful ba
drop of the Internet bust—offers so
lessons about hubris, overreaching,
human frailty. But Klein shies av
from any such deductions. *Stealing T*
is juicy, but there's little food
thought.

BY CATHERINE YA
Yang covers AOL from Washingt

RIPE STORIES OF AOL EXTRAVAGANCE AND TIME WARNER STUBBORNNESS, BUT NOT MUCH ANALYSI

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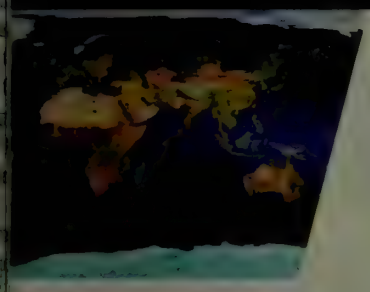

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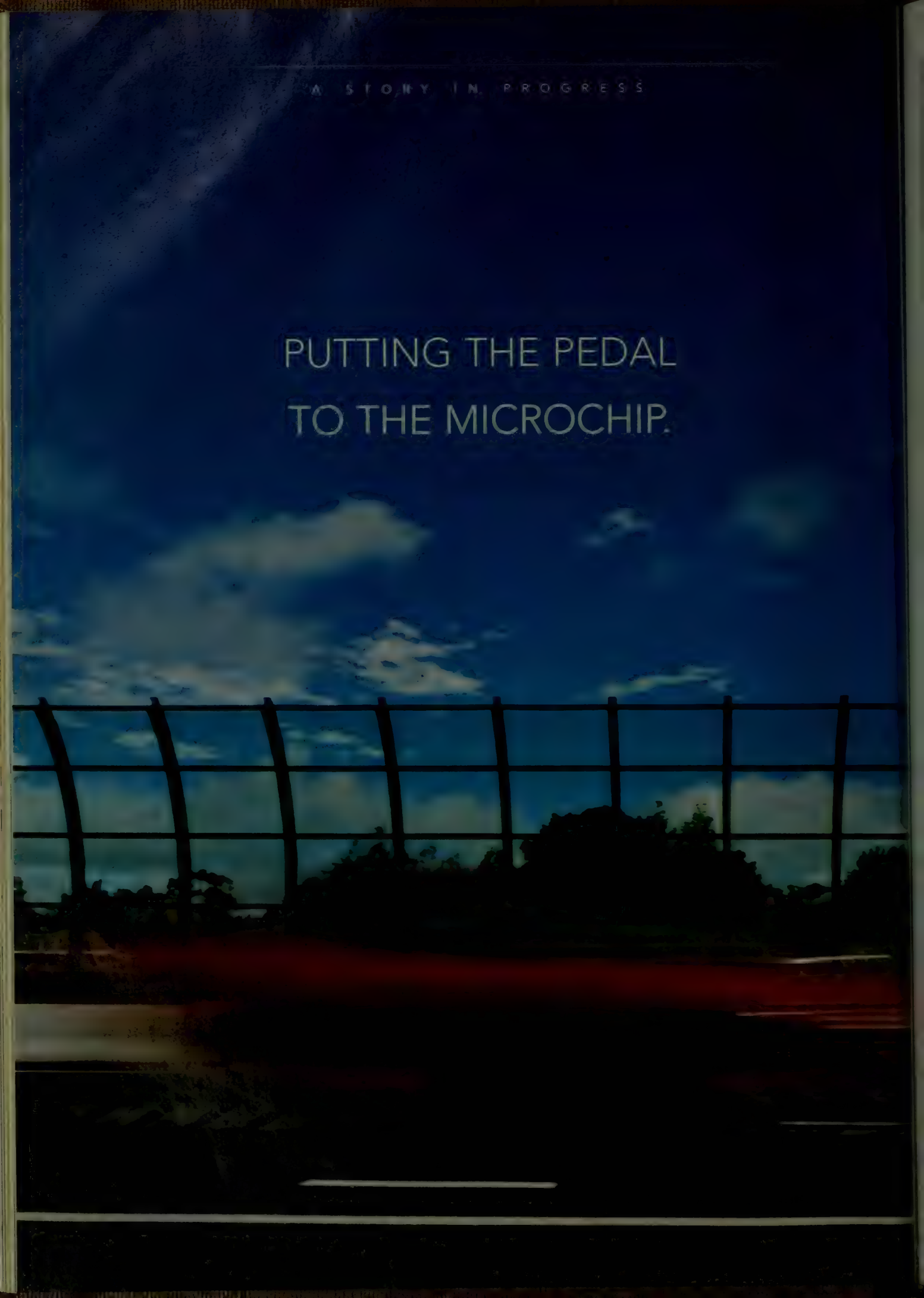

TODAY'S GM CARS AND TRUCKS ARE AS MUCH ABOUT BRAINPOWER AS THEY ARE ABOUT HORSEPOWER.

From DVD players that entertain the kids, to XM® Satellite Radios that entertain you, we use technology to make driving better.

And safer. When your front air bag deploys, our OnStar®[1] service pinpoints your vehicle's coordinates and calls for help. You can't see in the dark, so we created a technology that can. You don't have eyes in the back of your head, but our sonar-based rear-parking assist does. And since you're not always sure which way you're going, we put GPS on board.

These are just a few of the cutting-edge innovations available on a surprising selection of GM vehicles. And a few of the reasons why so many people are coming back. Last year, GM led the industry with more repeat customers than any other automaker. Drivers liked what they saw. And felt. And heard. And touched.

We're taking a more intelligent approach to car building these days. And it's one of the reasons we're back at the head of the class.

GM RADIOS GET A TUNE UP.

Music and driving go hand-in-hand. So when radio started shifting to satellite, we dialed right in. Today we install XM Satellite Radio on more vehicles than any other automaker. 101 all-digital channels cranking out whatever you want to hear, wherever you want to hear it. From rock 'n roll to reggae. From sea to shining sea. And it's available today in a GM dashboard near you.[2]

Going above and beyond with OnStar. It gets directions and makes reservations.[3] It even saves lives. Is there anything OnStar doesn't do? Not really. This GM-pioneered innovation has been the standard ever since we launched it seven years ago. And today, some 22 million customer contacts later, we're still going beyond the call. Here's a look at how OnStar helped last month:

- Responded to over 360 stolen vehicle reports.
- Called 575 people when their air bags deployed.
- Helped over 6,000 people involved in car accidents and emergency situations.
- Came to the rescue of over 13,000 stranded drivers who ran out of gas, got flat tires and otherwise needed our help.
- Ran diagnostic checks on over 13,900 vehicles.
- Popped the locks on 25,000 car doors.
- Gave directions to 223,000 lost drivers.

The all-new Saab 9-3 offers the ultimate personal touch, the Saab Profiler. This central computer lets drivers customize 40 different on-board systems.

Every Cadillac, including the head-turning Escalade, is equipped with a one-year OnStar service plan.[3] Now, getting assistance is only a button away.

The heads-up display available in the Corvette borrows technology from F-15 fighter jets, projecting practically every gauge onto the windshield.

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GM

CHEVROLET PONTIAC OLDSMOBILE BUICK CADILLAC GMC SATURN HUMMER SAAB

[1]OnStar uses existing emergency service providers and cellular telephone and satellite technologies. Vehicle electrical system must be operating for OnStar to work. Call 1-800-4-ONSTAR or visit www.onstar.com for system limitations and details. [2]Available in the 48 contiguous states. Activation fee and service subscription are extra. Go to www.xmradio.com for details. [3]Services vary depending on service plan purchased.

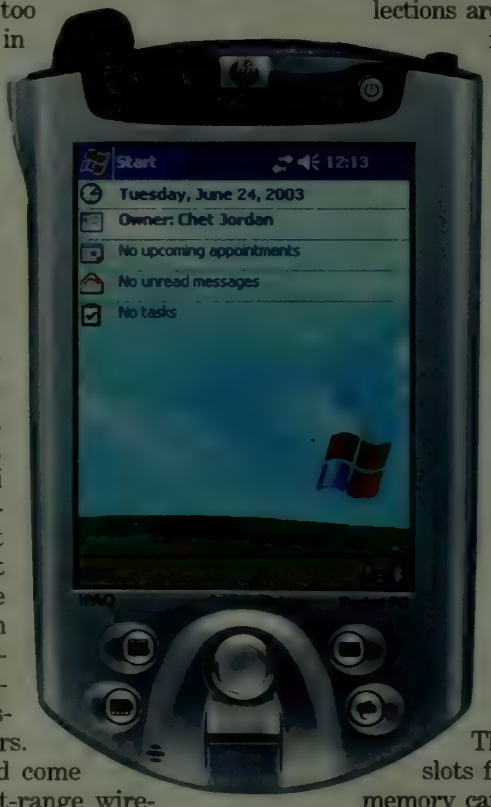
BY STEPHEN H. WILDSTROM
tech&you@businessweek.com

DESPERATELY SEEKING SIMPLICITY

The new iPAQs run Microsoft software that seems better suited to IT pros than to ordinary users

Over the past several years, few products have inspired as much ambivalence in me as the line of iPAQ Pocket PCs from Compaq and now Hewlett-Packard. From the first model in 2000, the iPAQs have been marvels of design that are both clever and beautiful. But I've never really gotten comfortable with the Microsoft Pocket PC software that ran on them. It has always seemed to try too hard to be a mini-Windows, in the process sacrificing the simplicity that remains the hallmark of Palm-based handhelds.

For the most part, this trend continues in the two new iPAQs that I tested, which are the leading edge of a generation of handhelds based on what has been renamed Microsoft Mobile for Pocket PC 2003 software. The newest iPAQs, both the thin, 5.1-oz. h2215 and the 7.3-oz. h5500 with built-in Wi-Fi wireless networking, are elegant products with big, bright screens and well-thought-out controls. Unfortunately, the software, while improved in many ways, still seems designed more for corporate information-technology professionals than for ordinary users.



Both models that I tested come with built-in Bluetooth short-range wireless. Bluetooth has a deserved reputation for being difficult to set up, but HP has eased the process with a set of wizards that give step-by-step instructions. Using the wizard—plus a bit of help from the AT&T Wireless Web site—I was able to get the h2215 to connect to the Internet through my Sony Ericsson T68i Bluetooth phone. Using Bluetooth to sync information with a Windows PC is more complex because of the limited Bluetooth support in Windows XP. But once it was set up, it worked beautifully.

Wi-Fi is a less happy story. Although Pocket PC 2003 automatically detects networks like Windows XP, configuring and managing network connections can be difficult. I found that working on my corporate wireless network, I had to configure the iPAQ one way to get mail and a different way to get onto the Web. Pocket PC 2003 includes two flavors of virtual-private-network s ware. This should let you get through most c porate firewalls, although you may need h setting up a VPN connection. I don't think Wi- is the ideal wireless option for handhelds (BW June 16), but if you want it, the simpler Pa Tungsten C is probably a better choice for th handling their own setups.

To some extent, the complexity of Pocket P networking is a price you have to pay for power. But I can't think of any excuse for crosoft's failure to remedy Pocket PC's mis able handling of Microsoft Office files. You ca do anything with PowerPoint presentations less you buy third-party software. The mish dling of Word files is shameful. If a docum contains fonts not available on the Pocket Pocket Word chooses the closest substitu That's fine for display purposes, but if the fil edited and sent back to a PC, the original font lections are lost. Even worse, any tab included in Word docume

POCKET POWER
Big, bright screens an well-designed controls

are mangled beyond rec nition or repair. Nea every Palm-based handh comes with either DataV Documents To Go or C ting Edge Softwar Quickoffice, and both all even complex Word files make a successful trip fr a PC to a Palm and ba It's hard to explain why crosoft hasn't done bett (TextMaker from SoftMa er Software, which I ha not tested, claims to so the problem on Pocket PC

That said, the iPAQs ha a lot of attractive featur The h2215, priced at $400, h slots for both SD and CompactFla memory cards. The h5500, listed at $6 has an SD slot and works with the existing arr of iPAQ accessory sleeves. Either way, you c add plenty of storage or additional communi tions options, such as wireless phone moden Each has a removable battery, especially han when using power-hungry Wi-Fi. Future Pock PCs, including new models from HP, will take a vantage of an important feature of the new so ware: support for integrated keyboards like tho on BlackBerries and the newest Palms.

Corporate IT departments like Pocket PCs their flexibility and security, and because th can use familiar Windows tools to develop custo programs. They have a lot of features with a peal to consumers, too, but they come with a of offputting complexity that may give you pau if you can't turn to the help desk when you r into problems.

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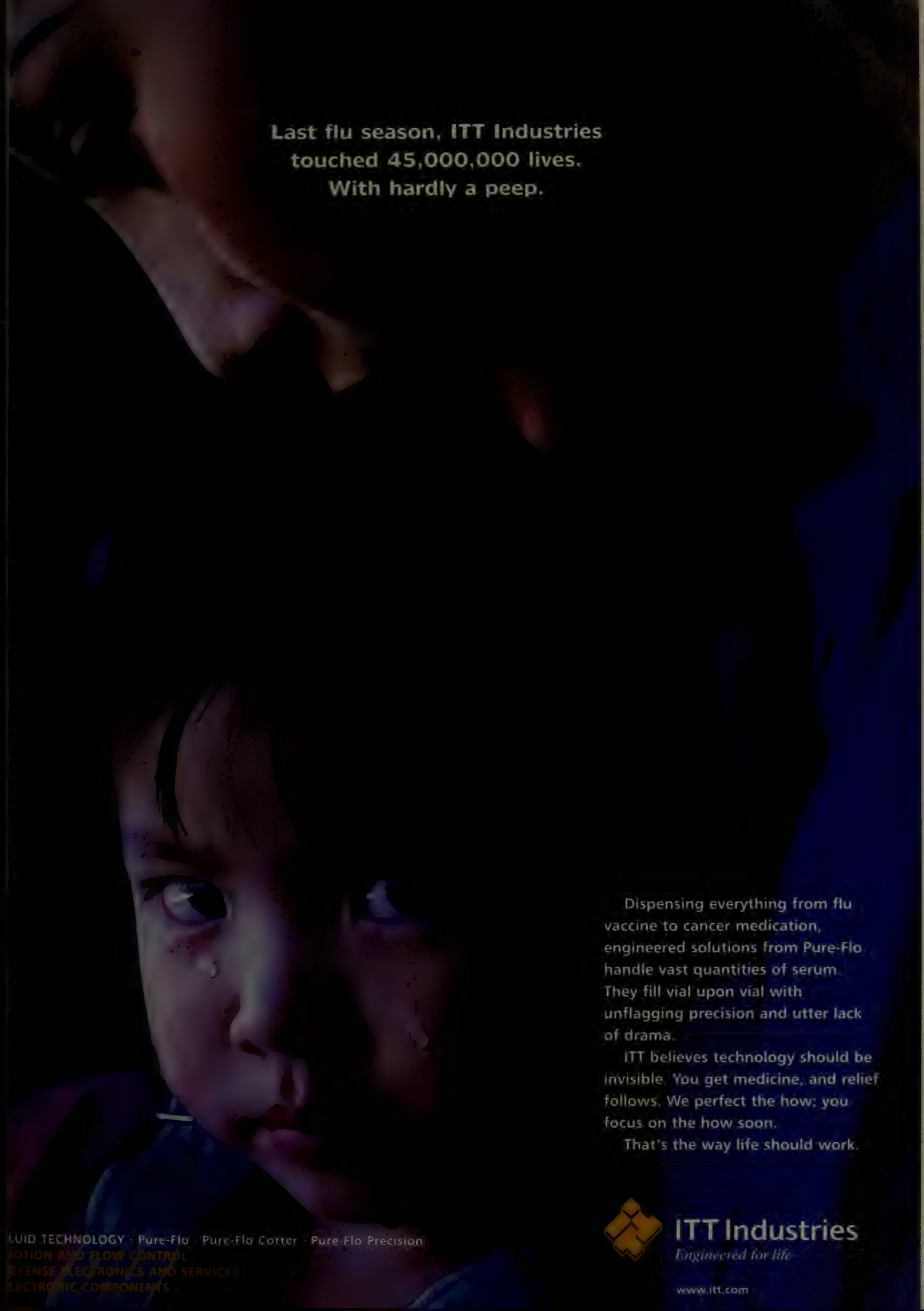
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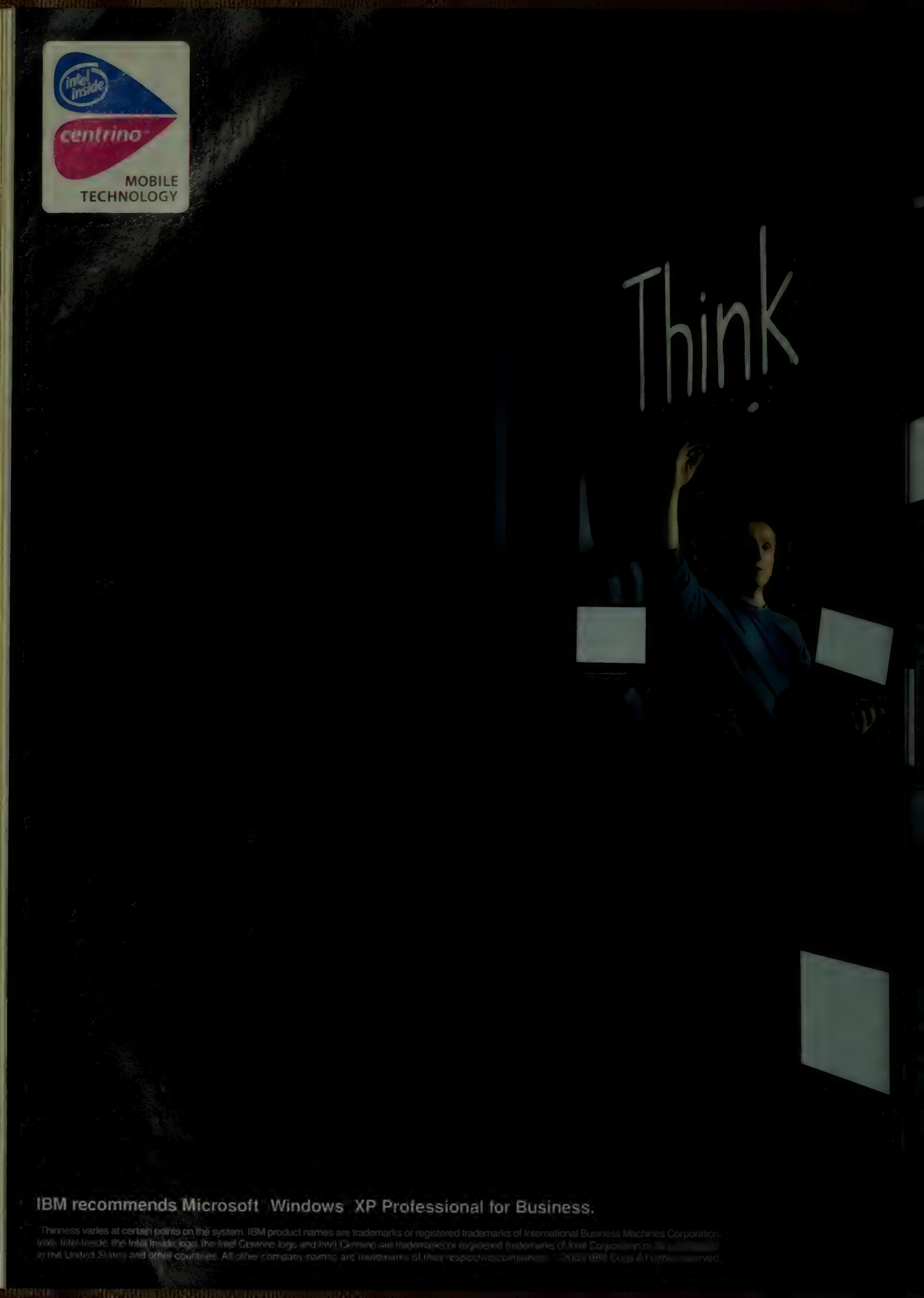

IBM recommends Microsoft Windows XP Professional for Business.

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BY ROBERT J. BARRO

MEDICARE: FORGET THE DRUG BENEFIT, AND FACE UP TO REAL REFORMS

FIX IT: Health care, like food and shelter, ought to be determined by income. But absent a free market, coverage should be for catastrophic events only

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).

Washington seems poised to make a major error on Medicare. The program's costs are out of control, and the situation will deteriorate further as the population ages. So the priority should be to make reforms that contain present and future costs, not only for Medicare but for health care generally. We should be considering basic changes to the structure of the health-care market. Instead, Congress likely will soon pass legislation that retains the existing structure and makes Medicare larger and more expensive by adding coverage of prescription drugs.

The problems of the health-care market begin with its reliance on third-party payments. Health providers are typically paid by insurance companies or governments, not directly by consumers. Thus, the typical consumer regards most of an additional dollar of health services as free. Not surprisingly, this environment promotes excessive demand and high costs.

Improvements to this structure are difficult partly because our society wants a system in which an individual's health care does not depend on an individual's income. Moreover, the quantity of care is not supposed to depend on costs. This makes it hard for the health sector to function in accordance with usual market principles.

Frankly, I do not understand why health care is viewed so differently from other consumer goods, including such essentials as food, clothing, and shelter. I accept that health services are difficult for consumers to evaluate, though the workings of cars and computers are equally incomprehensible to most people. The difficulties in evaluating medical treatment do suggest that people seek expert advice from third parties, which might look in some respects like HMOs or government agencies. But it is hard to see why this complexity means that incomes and prices should not play the role in the health-care market that they play in other markets.

Although the implementation of a free market in health care seems unattainable, there are less radical steps that could improve efficiency. One idea relates to health insurance coverage, which is often viewed as insufficiently widespread. The reality is the opposite for most people who have coverage—the amount of their coverage is usually far too large. Typical health-insurance plans have modest deductibles and co-pays, even for relatively low expenses, such as office visits to doctors. As insurance, coverage should emphasize catastrophic situations that can represent major blows to a person's standard of living. For smaller outlays, the health-care market wou work better if consumers paid for the servic they received.

One important reason for excessive coverage that health insurance benefits provided throug employers are not taxable income. The gover ment effectively subsidizes health insuranc which leads to too much coverage and, therefo excessive demand for medical services. Thus, have finally found something I would like tax—health insurance benefits. Most of the are fringe benefits paid for by employers, b small amounts that are now tax-favored are pa for by employees and the self-employed.

Similarly, Medicare has too much coverag and the extension to include prescription drug compounds the problem. To maintain incentiv not to overconsume drugs, coverage should subject to a substantial deductible, somethin like $5,000 per year. The only rationale for more generous program through Medicare that it redistributes income from the gener taxpayer to the elderly, who benefit substanti ly from the availability of new drugs. I unde stand the political attractions of giving mo money to the elderly. However, since the typic recipient of Medicare is not poor, I see no equit argument for this redistribution.

The one structural change to Medicare th the Administration had been pushing but is no deemphasizing involves the expanded use of pr vate managed-care plans to provide prescri tion-drug coverage. Although this proposal is i tended to achieve cost savings through expande reliance on private providers, there's not muc reason to think this plan would save mone Mark Duggan of the University of Chicago h studied the use of private providers in analo gous programs—state-run Medicaid systems th provide health-care coverage for low-income pe sons ("Does Contracting Out Increase the Eff ciency of Government Programs? Evidence fro Medicaid HMOs," National Bureau of Economi Research, August, 2002). Nationwide, the pe centage of Medicaid recipients in managed-car plans rose from 10% in 1991 to 56% in 200 Duggan found that in California managed car led to a substantial jump in government ou lays. There were no discernible effects on healt outcomes, though researchers typically have trou ble isolating health effects for any kind of pr gram or treatment. In any event, the Medica evidence suggests that managed-care plans wi not be a big part of a solution for fixin Medicare.

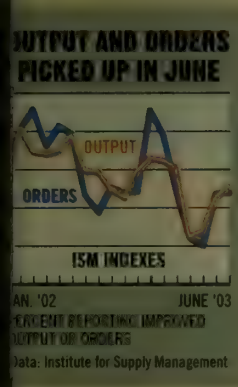
AMES C. COOPER & KATHLEEN MADIGAN

HE SKITTISH BOND MARKET /ON'T SHAKE HOUSING—FOR NOW

tes must rise more than a point to hurt. But it's another story for refis

U.S. ECONOMY

Over the past three years, the U.S. economy has been clob-ed by unforeseen events, but housing continued to ve up to set sales records in both 2001 and 2002. e again, sales are on track to hit another peak in 3. Now, though, housing faces its biggest challenge his business cycle: rising mortgage rates.



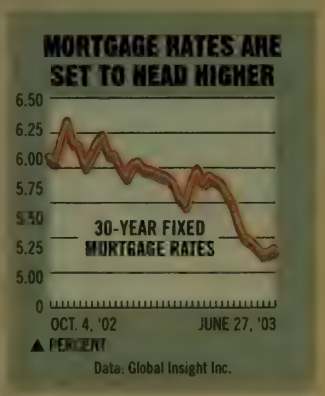
The Federal Reserve and the bond market are in a tussle over the fate of long-term interest rates. Since the spring, the Fed has highlighted the risks of deflation, or at least slowing inflation, in an attempt to talk down long rates. The bond market interpreted the central bank's focus as a signal the Fed would cut short-term rates at its e 24-25 meeting and would hold rates down for the seeable future. But traders were disappointed when Fed cut its federal funds rate by only a quarter nt, to 1%. Many investors took trading positions icipating a half-point cut. When those positions un-nd, bond prices fell and yields rose.

ates are also edging up because the economic news been improving. Consumers spent more in May, and chasing managers said the factory sector is close to upturn with orders and output increasing in June art). The upbeat tone of the data suggests that the overy entered a faster-paced phase, even before Bush tax cuts funnel more money into people's lets. Bond traders know that as spending picks up, deflation risk will dissipate, so they are already de-nding better yields on long-maturity bonds. The ld on the 10-year Treasury bond has risen from 1% in mid-June to 3.51% on June 30.

Eventually, mortgage rates will follow bond yields her, but probably not enough to topple housing. rowing costs have fallen so low that even if mort-e rates rise by a full percentage point, home sales n't suffer all that much. What will take a hit is refi-cing activity, which has been a major source of ds for consumer spending.

A TRADITIONAL ECONOMIC CYCLE, housing has n both a whipping boy and a savior. When the nomy is peaking, higher rates choke off home buying, and housing leads the economy into a downturn. After a recession causes the Fed to be more accommodative, low rates unleash pent-up housing demand. Sales and construction take off like Ferraris, pulling the rest of the U.S. economy higher.

In this atypical cycle, however, the sector has acted more like the family sedan, moving steadily forward without much flash. Even in 2001, when the economy was in recession, both housing starts and sales managed to post small gains. The uptrends have continued into the recovery. In fact, residential construction, which is only about 4% of real gross domestic product, accounted for 7.5% of overall growth in 2002 and one-third of the advance in real GDP in the first quarter.



Housing's ascent has been a mirror image of the downward trend in long rates. The average 30-year fixed mortgage rate has declined from 8.5% in mid-2000 to 5.24% now (chart). That translates to a huge saving of $325 a month for a $150,000 mortgage. Consequently, home buyers have had more room to bid up prices nationwide. Climbing home values have added to household wealth and consumers' sense of well-being.

SO WHAT HAPPENS when mortgage rates begin to rise? Fortunately, the drag may not be that great on home sales. Given the link between sales and rates over the past 13 years, *BusinessWeek* calculates that if mortgage rates edge back up to 6.25%, or by about one percentage point, by the end of the year, new home sales in December would be about 7% lower than their record pace of the first five months of this year; resales would drop by about 9%. But for the whole year, new sales and resales would post records.

Higher rates will have a bigger negative impact on the refi front. The Mortgage Bankers Association of America (MBA) is forecasting that mortgage rates won't get near 6% until mid-2004. By then, they expect the share of new mortgages to refinance existing ones will fall to 34%, from 68% in the second quarter when refi applications hit a record.

Refis have been generating extra cash for consumers. A Fed study shows 45% of homeowners take out some

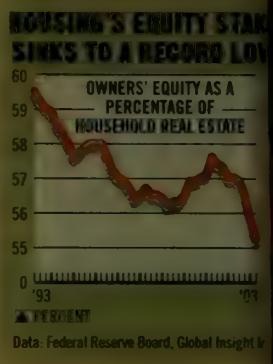
equity when they refinance. These cash-outs, which averaged nearly $27,000 in 2001 and early 2002, is usually used to repay debts, finance home-improvement projects, or purchase new goods or services. With rates edging back up, the refi window is closing for many homeowners, and consumers will lose a source of easy money.

The three-year drop in mortgage rates has also offset the stagnant job market's effect on mortgage delinquencies. The MBA reported that both the foreclosure rate and the delinquency rate were little changed in the first quarter from the fourth, and the delinquency rate is down from its previous-year level. Job losses and rising personal bankruptcies caused some homeowners to run into difficulties. But falling interest rates have allowed many others to refinance their mortgages, resulting in lower monthly payments.

TWO IMPORTANT TRENDS in housing—rising homeownership and massive refi cash-outs—have given rise to two seemingly conflicting truths about consumer finances. The amount of consumer wealth held in real estate is the highest ever. But consumers' equity stake in their homes is the lowest on record (chart). The contradiction is caused by rising home prices and ultralow interest rates.

Rising real estate values have made homeowners richer. According to recent Fed data, owners' total net equity in real estate—the home value less its mortgage—climbed to a record $7.7 trillion in the first qu ter, a $366 billion gain from the year before.

But at the same time, the surge in first-time homeowners, the waves of refinancings, and easy home-equity loans mean that on average homeowners hold less equity in their houses than at any time before. In the first quarter, the stake was 55.2%, down from 57% the year before and well below the 66%-to-68% range of the 1980s.



Given the skittishness in the bond market, cou long rates jump by more than one percentage poin That scenario is possible, but since rising inflation nowhere on the horizon, higher rates would be the r sult of the economy showing greater muscle in t second half than most analysts now expect. That wou mean better job growth than is now projected a bigger pay raises for workers. Both would be pluses f housing demand and would offset any drag from hig er rates.

To be sure, the housing sedan is downshifting. B nothing in the outlook for interest rates or econom growth suggests that the home-sweet-home sector w run completely out of gas in the next few quarters.

ARGENTINA

COLD WATER ON HOT MONEY

Argentina is trying to stem the flow of hot money into the country. But the economy might get burned.

On June 25, Economy Minister Roberto Lavagna said the government will force foreign investors to keep their money in Argentine securities for at least 180 days. The action is partly a move against speculation in the stock market, which has more than doubled in value over the past year. Lavagna said short-term capital inflows, or hot money, hit $900 million in the past month compared with $550 million three months earlier.

The capital restrictions are also designed to prevent a sudden drop in the peso, which has risen about 20% against the U.S. dollar this year. Officials want a controlled depreciation of the peso to lift exports. Argentina is coming off of a four-year recession, and foreign trade is seen as a growth engine. That's why the capital restrictions do not cover industries involved in trade.

But such exemptions are one reason analysts doubt the restrictions will work, and why Argentine stock and bond prices fell after the announcement. Also, there are questions as to how much of the recent inflow is money brought home by Argentinians who had invested elsewhere but now see improvement in their economy. Real gross domestic product grew 5.4% in the year ended in the first quarter. For all of 2003, the economy may grow 5%, after shrinking almost 11% last year.

So far, the moves have not exerted much downward pull on the peso, which traded at 2.7975 to the dollar at the end of June. President Nestor Kirchner has indicated he would like an exchange rate of 3 pesos to the dollar.

The International Monetary Fund is reviewing Argentina's plan, and the restrictions may play into the final details of an IMF credit program expected by September. Given Argentina's need for capital investments to give the nascent recovery momentum, a plan to keep money out of the financial system may not be a prudent move. ■

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SIGNS OF LIFE

A few gutsy companies think now is the time to grow

Less than 10 years ago, Washington Mutual Inc. was a little-known regional thrift in the Pacific Northwest. Today it ranks as the biggest savings institution and mortgage lender in the nation, with $277 billion in assets and 2,500 offices coast to coast. But that's still not big enough. The Seattle company is spending some $210 million to build 250 branches this year, backed by an advertising blitz to make sure consumers in its new markets no longer wonder what it is. Chief Executive Kerry K. Killinger says he will match those numbers in 2004 as he makes good on his plan to make WaMu the Wal-Mart of consumer banking.

Gutsy? You're not kidding. After wandering the economic desert for several years, many companies are just trying to cut costs and hold on until the long-promised, much-delayed recovery arrives. Despite some signs the economy is starting to improve—the stock market has come alive, business spending on technology rose 5.9% in the first quarter compared with a year earlier, and even manufacturing is starting to turn up—much of Corporate America remains skittish.

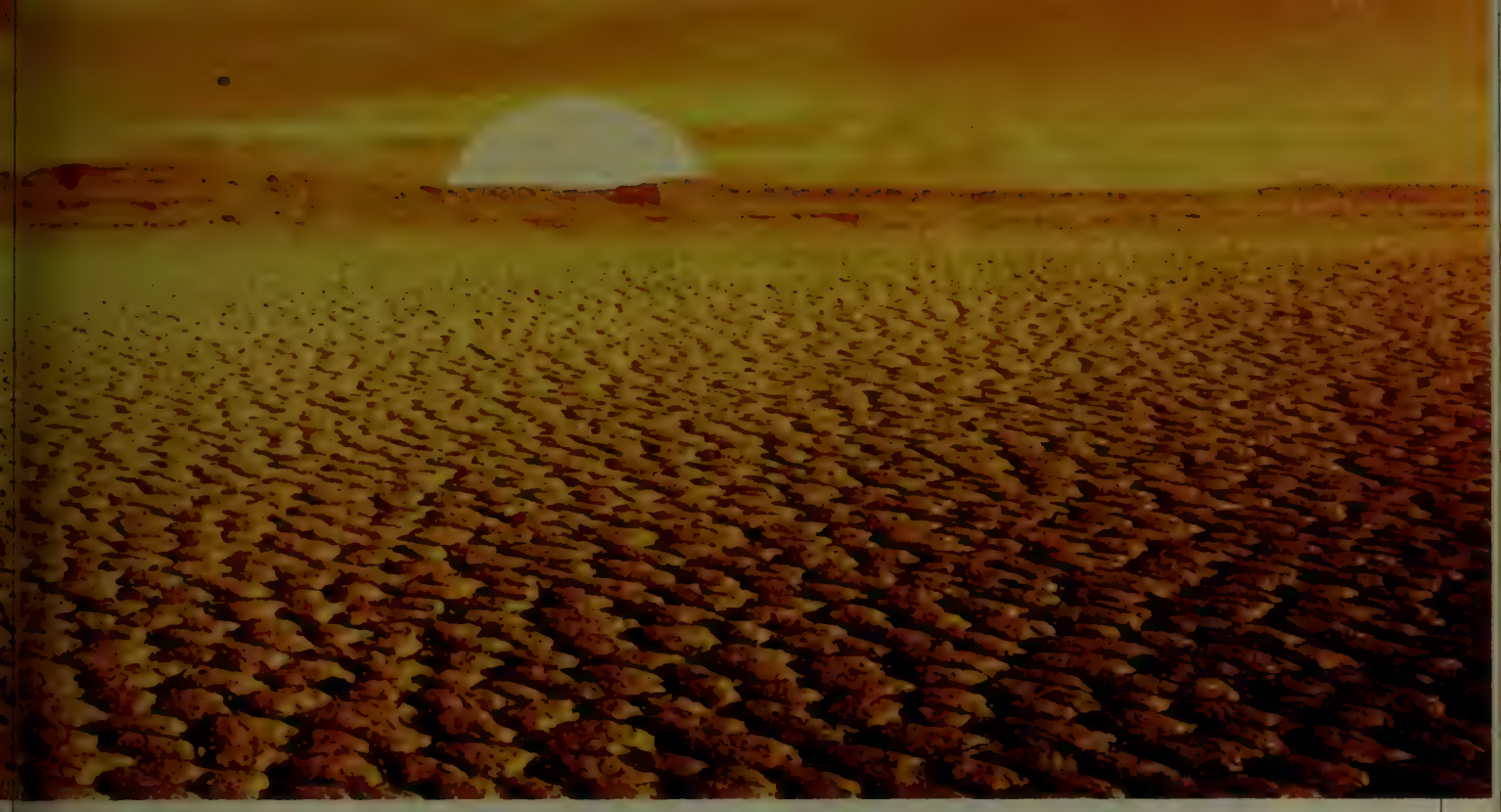
But here and there, bold companies like WaMu are moving forward. They aren't waiting for the economy to turn. Instead, taking advantage of their own strong bala sheets and the availability of cheap m ey, these damn-the-torpedoes outfits steaming ahead. They are boost spending on capital investments, rese and development, and marketing. The breaking into new markets, launch new products, and starting to think ab

FULL SPEED AHEAD

While the overall economy is still struggling, some companies are moving forward with expansion plans by:

BOOSTING CAPITAL SPENDING

IT s is co back com invest in new tech gies. Verizon will s $13 billion this ye part to string fiber cables to custome



ls. They're making acquisitions. ey're even hiring.

Sure, the moves might come back to them if the economy stalls. Detroit's industry is one example of the dangers of betting on an upturn too soon. As economy gained momentum last year, Big Three ramped up output. But n as those new cars were rolling off embly lines, the economy stalled at rend. Forced to lay on more cash-k rebates, cheap financing deals, and er costly incentives to try to empty ler lots, they've seen profits squeezed. But if the companies betting today on nger markets are right, that gamble ld be their wisest move yet. A re-t McKinsey & Co. study of 1,200 com-ies over the past 20 years shows that ny of today's industry leaders raced her ahead of the pack by increasing nding during the 1990-91 recession. telling example: Intel Corp., which re than doubled its R&D spending be-en 1989 and 1992, to $780 million, ile pumping up capital spending as l. It's no accident that Intel commands % of the $24 billion market for PC cessors. "Making a big bet is the thing t allows you to build sustainable advantage—in technology, manufacturing improvements, or relationships. You spend, and others don't," says Donald N. Sull, assistant professor of business administration at Harvard Business School.

This time around, though, rivals may feel compelled to spend to keep up—and that could be key to keeping the economy from slipping out of gear. Thanks to low interest rates and the expected kick as tax cuts pump an estimated $200 billion into the economy by fall, economists predict gross domestic product will expand by 3.5% or more in the second half. But many fret growth will peter out once again in 2004 unless companies pick up the slack from consumers, who have single-handedly kept the economy going.

So who are these corporate daredevils? Not surprisingly, many of them are in the technology industry, where the risk-taking spirit is strong (page 34). Verizon Communications Inc. is spending $13 billion this year—almost half what the entire domestic telecommunications industry will spend. A chunk of that will fund a 10-year program to string fiber-optic cable to every one of its home and business customers, bringing them videoconferencing and interactive television. Others are using fresh ideas to strike paydirt. Apple Computer Inc.'s online iTunes Music Store sold 3 million songs at 99¢ a pop in the first month after opening its venture on Apr. 28, while rivals struggled to sign up monthly subscribers.

Replaying its well-timed move of a decade ago, Santa Clara (Calif.)-based Intel is once again investing for the future—big time. While most of its rivals were putting on the brakes in the first year of the tech downturn, Intel spent $11.5 billion on R&D and capital expenditures, a staggering 45% of revenues. That's now enabling Intel to introduce powerful new chip designs for wireless notebooks, cell phones, and other portable devices. "The combination of putting communications capabilities with computing capabilities is starting to roll out," says CEO Craig R. Barrett.

Increasingly, however, companies outside of tech are also upping their spending as they pursue aggressive expansion plans. Take AirTran Airways Inc., a fast-growing upstart that has been steadily making money even during the airline industry's worst downturn. The Orlando-based discount carrier operates today with 76 aircraft. But on July 1, in a deal

ING **TS** Some companies are showing they can still succeed with a smart idea. Computer, for instance, is selling millions of songs over its new online Music Store.

ENTERING NEW MARKETS Bucking the natural tendency to hunker down, Washington Mutual has been opening some 250 branches a year. Chicago will get 70 new branches this year; Tampa is next.

INCREASING MARKETING Advertising, which has been in a slump since 2000, is starting to perk up. Among today's bigger spenders: Hewlett-Packard, and Kellogg.

BOLSTERING R&D Market leaders like Intel are wagering that boosting R&D spending now will pay off when demand recovers. It has upped spending 4% this year, to more than $4 billion a year.

valued at up to $5 billion, AirTran ordered 50 planes from Boeing Co., with an option for 50 more.

Others are breaking from the pack by getting into new markets. Consider Logitech International, which has won a loyal customer base through clever design. Now the company, known for its computer mouses and keyboards, is leveraging that brand loyalty and its design skills by moving into a host of other product lines. Fiscal 2003 sales jumped 17%, to $1.1 billion, due in part to new products such as special notepads that convert handwriting to digital print through a PC. And with a new line of speakers coming out, it expects sales to climb an additional 9% in the fiscal year that ends Mar. 31, 2004.

Some early birds are also replenishing their marketing budgets. Hewlett-Packard Co. is cranking up its ad spending twelvefold this year, to $400 million, according to TNS Media Intelligence/CMR, an ad-tracking firm. That should help repair its brand after its bruising takeover of Compaq Computer Corp. Nontech companies, too, are stepping up to the plate. Kellogg Co. is adding 5% to its budget this year as it rolls out cereals such as Tony's Cinnamon Krunchers. Media analysts are forecasting overall ad spending will grow at least 4.5% this year, compared with about a 2.5% rise in 2002.

It's easy, of course, for executives to come up with plenty of reasons why they should sit on their wallets. Even as cost-cutting has helped profits inch up, many companies are struggling with stagnant sales and little leverage to raise prices. At the same time, much of the economy remains saddled with unneeded capacity. "If anybody builds to add to capacity, people would say they're out of their minds," says Norbert J. Ore, manufacturing chairman of the Institute for Supply Management. "We still have a s our-way-to-prosperity mentality."

That's not a mistake Washington tual intends to make anytime soon. company opened 28 branches in Chi in June, with plans for 70 by year Some of its customers are brand-new most came from established banks suc Bank One Corp., which had been bac away from retail banking since the 1990s. Now, to fend off WaMu, Bank has reversed course and begun ad branches of its own, with 13 planne this year and 15 in 2004. WaMu's c termove? With its beachhead in Chi secured, it's planning to build at lea sites in Tampa, starting next year. Fo that tale about the tortoise. In to market, it's the hare that wins the r

By Michael Arndt in Chicago, Steve Hamm and Steve Rosen in New York and Cliff Edward San Mateo

TECH M&A: THE LONG, COLD WINTER MAY BE OVER

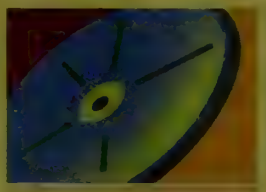
From Silicon Valley to Wall Street, the talk since June 6 has been dominated by Oracle Corp.'s takeover bid for rival software maker PeopleSoft Inc. Put together Oracle's eccentric CEO, Lawrence J. Ellison, and a rare—for tech—hostile $6.3 billion offer, Hollywood couldn't have come up with a better script.

Oracle's move is having real-life repercussions across the tech sector. Companies that were confident about riding out the downturn are feeling vulnerable. "This deal has rocked people out of that false sense of security," says Paul Deninger, chairman and CEO of New York-based Broadview Holdings, a tech investment bank. "Everybody knows they could be in play, and they have to think differently."

Many already are. Investment bankers say their phones have been ringing off the hook and their workloads have shot up in the last month. Suddenly, wide-open calendars are packed with brainstorming sessions. Merger discussions that were lukewarm at best are heating up. "Larry broke the logjam," says Jeff Mortara, head of West Coast technology investment banking at Deutsche Banc Alex. Brown Inc.

Ellison isn't the only catalyst, of course. With tech stocks on a sustained upward trajectory, execs are sensing that valuations have finally bottomed out. Low interest rates are also helping buyers raise capital more easily. And they've finally begun to focus on growth instead of cost-cutting.

HOT SPOTS? *Among the high-tech sectors where M&A deals are most likely to emerge:*

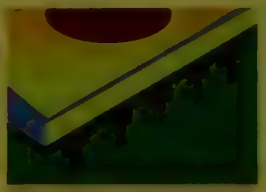


SOFTWARE

With more than 700 corporate software makers, the sector is ripe for consolidation

NETWORKING

Cisco and others are doing deals to move into hot technologies such as Wi-Fi



CHIPS

Intel and Sun are buying small outfits to improve chip speed and energy use

So where's the action likely to happen? Look no further than industry heavyweights such as Sun, IBM, Microsoft, and Cisco Systems. It's not just that these companies have mountains of cash. They are also seeking technologies that can open new markets and revenue streams. Take the June 26 acquisition of Pixo Inc. by Sun Microsystems Inc. The San Jose (Calif.) upstart's technology makes it easier to send digital content to mobile devices. Sun, which expects to do at least three more deals by yearend, wants to incorporate Pixo's software into its wireless strategy.

Another area that's ripe for dealmaking is corporate software, with more than 700 players. "For the last 12 years, the one thing you could count on is that no deal happened in software except when a company was i distress," says Roger H McNamee, a technolog investor at Silver Lake Partners in Menlo Par Calif. "So it's a virgin field, with massive ex- cess capacity."

Don't expect an ava- lanche of deals overnight, though. Any significant rise in vol- ume isn't likely to sho up until late this year or early 2004. Instead, companies will spend the next few months mapping out strategic initiatives and identifying acquisition targets. That may be good news for investment bankers, who are hoping t end a nearly three-year lull. But for PeopleSoft and other companies tha would rather go it alone, it's time t watch their backs.

By Linda Himelstein and Jim Kerstetter in San Mateo, Calif.

UCATION

BEAR MARKET N B-SCHOOL APPLICATIONS

the likelihood of a hot job fades, so does the MBA's allure

ecessions usually are good for busi- ness schools. Applications flood into such august institutions as the arton School, Dartmouth College's k School of Business, and Stanford iversity as the young and talented he corporate world opt to hide out in duate school, earn an MBA, and erge when jobs are plentiful again. For the first two years of the current vnturn that pattern largely held. But s year, business school is suddenly s of a draw. Applications for the B- ool Class of '05—the students who l hit the books this fall—have fallen as much as 30% at some top schools npared with last year. The Universi- of Chicago's Graduate School of Busi- ss, for example, has received 27% er applications for the autumn term n it did in 2002.

Why the drop-off? For one thing, few- would-be applicants can afford to for- their salaries or pay annual tuition of ,000-plus. And new visa restrictions making it harder for foreigners to ly. But the big reason many twen- omethings may be hanging on to their s, however unrewarding, is that the e-coveted MBA no longer comes with implicit guarantee of a big-bucks job er on graduation. "When the down- n is this prolonged, the optimism es," says Daphne Atkinson, vice-presi- nt of the Graduate Management Ad- ssion Council, which administers the AT entrance exam.

It's easy to see why America's fledg- g manager class is balking these days. er the past two years, potential MBA ndidates have watched many B-school ads flail upon re-entering the real rld. Consider that some 30% of grads *BusinessWeek*'s Top 30 MBA programs d no solid job offer at graduation in 2. Two years earlier, only 2% went gging. So while an MBA might en- nce a would-be executive's prospects the economy picks up, the current p of overachievers isn't about to for- e a regular paycheck. Says a New rk investment banker who had nned to go to B-school: "I want to ld on to my job."

You can't blame him, since there are v signs that the job market is im-

STILL LOOKING Blaydon is one of the 29% of '03 Tuck grads with no job yet

proving. Many B-schools say job prospects are similar or only slightly better for the Class of '03. At Dartmouth's Tuck, for instance, some 29% of spring graduates had no job at commencement. A typical example is Christopher Blaydon. Despite dozens of interviews, he has yet to land a job in strategy consulting or strategic planning.

And it's not just job prospects—affordability is another issue. Many potential MBA candidates have found their paychecks shrinking and their savings and investment portfolios dwindling—which makes financing a pricey MBA more difficult. Meanwhile, lower investment yields have left some schools with fewer fellowships and scholarships to attract students. Sherry Wallace, admissions director at University of North Carolina's Kenan-Flagler Business School, says her institution will award one-third fewer fellowships this year than last.

Tougher visa rules, a weak global economy, and even SARS-related travel restrictions have prompted fewer foreigners to apply to U.S. B-schools, too. Although foreign MBA students have made up roughly 35% of the class over the last decade, B-school deans expect that number to fall this year. While the impact of SARS and slow economic growth overseas are likely to be short-lived phenomena, the schools are more worried about visa rules that were tightened in the wake of September 11. "We have an applicant who works for the president of a country, and he can't get a visa," says Stuart I. Greenbaum, dean of the John M. Olin School of Business at Washington University in St. Louis.

Smaller Pool

Percentage of B-schools reporting a drop in applications

2002-03	53%*
2001-02	45%

*Preliminary results
Data: Graduate Management Admission Council survey

With fewer people to choose from, B-schools are digging deeper into their applicant pools to fill the fall roster. "Right now, many [schools] are still working their wait lists even though it is fairly late in the game," says Joseph P. Fox, associate dean at Olin. As the big schools get less picky, lower-ranked ones could find it hard to fill their slots.

The problems may not end there: The next application cycle—for the Class of 2006—kicks off in November, just four months from now. "It's difficult to predict what next year will look like, especially in light of continued economic uncertainty," says Julia Min, assistant dean at New York University's Stern School of Business. If the job picture doesn't improve soon, the B-school blues may well continue.

By Jennifer Merritt in New York

COMMENTARY

By Howard Gleckman

THIS MEDICARE REFORM IS NO CURE

After a decade of debate, Congress is moving to approve the biggest expansion of Medicare since the program was created 40 years ago. On June 27, the House and Senate each passed separate versions of a restructuring package and, by fall, Congress is likely to send a final bill to President George W. Bush. Supporters aren't shy about promoting its benefits, including its centerpiece—a new prescription-drug plan projected to cost taxpayers at least $400 billion over the next decade.

Although lawmakers still must slog through scores of contentious details, they're likely to reach a compromise that finally will bring the massive federal health program for seniors into the world of modern medicine, backers say. Retirees will get some medicines paid for, a key benefit offered by nearly every private insurance plan in the U.S. but never added to Medicare. At the same time, the legislation aims to fundamentally overhaul the program by luring seniors into more efficient managed-care plans run by the private sector. The theory: The shift will improve treatment and save taxpayers money, helping to rein in ballooning Medicare costs while offsetting the expense of the drug benefit.

Those are laudable goals. Unfortunately, Congress isn't likely to achieve them. In an effort to compromise between Democratic demands for a big drug benefit and GOP efforts to open Medicare to market-based competition, lawmakers will accomplish neither. Originally, Bush wanted to require seniors to join managed-care plans in order to get drug insurance. But that approach was rejected on Capitol Hill. The likely compromise will allow retirees to switch voluntarily out of traditional fee-for-service Medicare.

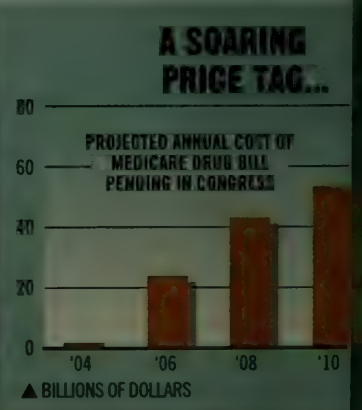
Problem is, there won't be much incentive for them to do so. The GOP hopes private insurers can save enough money through managed care to eventually offer better coverage to seniors who sign up. But experts are skeptical. And insurance companies, fearing the coverage will be unprofitable, are demanding extra subsidies to participate.

Health analysts are even more doubtful that the elderly will flock to new managed-care networks. Instead, most probably will remain in traditional Medicare, producing few savings to fund drug insurance. "Everybody can claim victory, but the extent to which the damn thing works isn't clear to me," says Bruce C. Vladeck, who ran Medicare for President Clinton. Adds University of Minnesota health economist Roger Feldman, a staunch supporter of privatizing the program: "I'm disappointed. Politics has trumped reform."

It won't be the first time. Washington experim with managed care starting in with a program called Medicare which allowed companies to off coverage to seniors who joined plans. But federal payments to surers failed to keep up with d digit cost increases, so they tri benefits. Eventually, many drop program altogether. At its peak 16% of retirees participated. N about 11% are enrolled.

The new reforms try to avoi pitfalls of that effort. For one,

DRUGS FOR SENIORS: PRICIER THAN YOU THINK



PHOTOGRAPH BY CLAUDIA KUNIN/CORBIS. CHART BY LAUREL DAUNIS-ALLEN/BW

e+Choice, the government set paid to insurers. The new law companies bid for contracts. To encourage them to participate, rnment is likely to provide exidies, such as reinsurance, to them against losses. Insurance s are already pushing for Con-

"Everybody can claim victory, but the extent to which the damn thing works isn't clear," says former Medicare chief Bruce Vladeck

sweeten the pot. But that nly add to the taxpayer's tab. e the bill is finalized, the House ate will have to settle two big should the government offer a drug plan in regions of the where private insurers will not, much competition should be ed after 2010? Still, at their e two versions are remarkably Seniors will get a drug discount rting next year. Beginning in ey will be eligible for Medicare surance. To get it, they will have to pay a monthly premium of about $35 for a benefit that will cover about 25% of their costs.

While seniors won't have to switch to managed care to get their drug benefits, most of them will have to buy the insurance from private companies. They will either get it as an add-on benefit to go with old-style Medicare, or as part of a private plan that will cover the costs of hospital and doctor care as well as drugs. "We need to keep rewarding innovation and protecting competition," Bush said in a June 23 speech on the new legislation.

But real savings will come only if seniors opt to get all of their coverage from the private sector, not just the drug benefit. Insurers say they can cut costs and improve care for Medicare patients if the government gives them the flexibility. One way to do that is through disease management, a system of identifying patients at risk for high-cost chronic illnesses and working closely with them to control their conditions before they suffer a medical crisis.

The idea has shown promise among employer-based health-care plans and it could be a big help to the elderly. After all, almost half of all Medicare funds are spent on just 5% of seniors—43% of whom suffer from diabetes and 59% of whom suffer from congestive heart failure. But health-care experts aren't sure that such preventive measures can work with many seniors, especially the 30% of high-cost patients suffering from impairments such as Alzheimer's disease.

Another potential advantage for private insurers is their ability to cut costs by removing high-priced, low-quality doctors and hospitals from their managed-care networks. But that would force seniors to find new doctors, something most are loath to do.

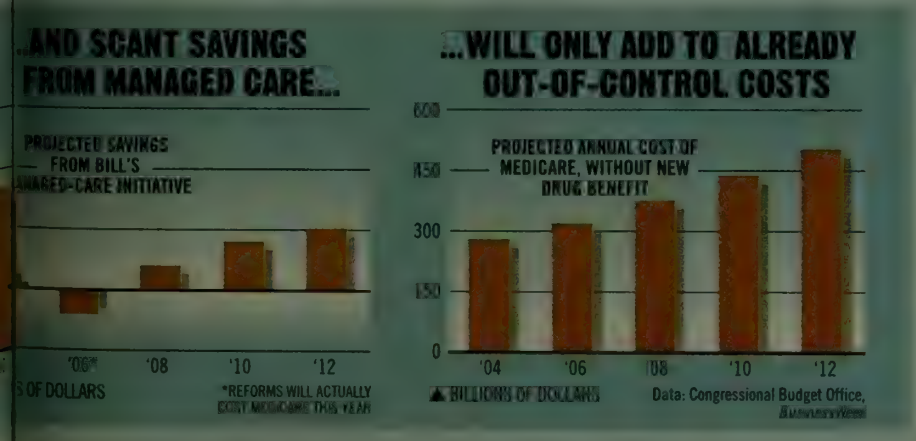
Whether such tactics work or not, the muddled compromise that is in the works on Capitol Hill means they won't be put to the test for years. At least at the outset, private plans will be limited in their ability to compete with traditional Medicare. The House bill would open the system to more competition, but not until 2010. So far, no insurer has yet committed to selling Medicare coverage. Companies worry whether they will be able to profit from the arrangement, says Edward L. Wristen, CEO of First Health Group Corp., a managed-care company based in Downers Grove, Ill.

At the same time, less than 10% of seniors are likely to join a private-sector plan, according to the nonpartisan Congressional Budget Office. Some advocates insist that as retirees see the benefits of private plans, more will make the shift. For example, the Administration's Centers for Medicare & Medicaid Services (CMS) thinks that eventually some 40% of the elderly will join the new plans. But even CMS Administrator Thomas A. Scully doubts that that will happen anytime soon. "The majority of seniors for the rest of my lifetime will be in fee-for-service Medicare," he says.

If managed care doesn't catch on, the savings will come to a paltry few billion dollars a year, the CBO estimates. Meanwhile, even skimpy drug coverage will cost the nation's taxpayers a lot more than the advertised $400 billion over a decade. Indeed, the program's tab could hit $70 billion a year by 2013. Given that the annual cost of Medicare is already expected to double by then, to a staggering $500 billion a year, the extra $70 billion would only worsen the program's fiscal woes. The legislation just delays "a serious discussion down the road about how we are going to finance Medicare," says Stuart H. Altman, a Brandeis University health policy professor.

All of this uncertainty is one reason why Urban Institute economist Marilyn Moon calls Medicare reform "faith-based health care"—that is, a massive bet on unproved theories and wishful thinking. Privately, many lawmakers concede that the new law will fall far short of expectations on all sides. Congress will pass Medicare reform this year because it is afraid to incur the wrath of seniors if it doesn't. But don't expect this political compromise to improve the health of most retirees—or boost the solvency of the troubled Medicare program.

Gleckman follows health policy from Washington.



HEALTH CARE

FOR-PROFIT HOSPITALS: COMING UP LAME

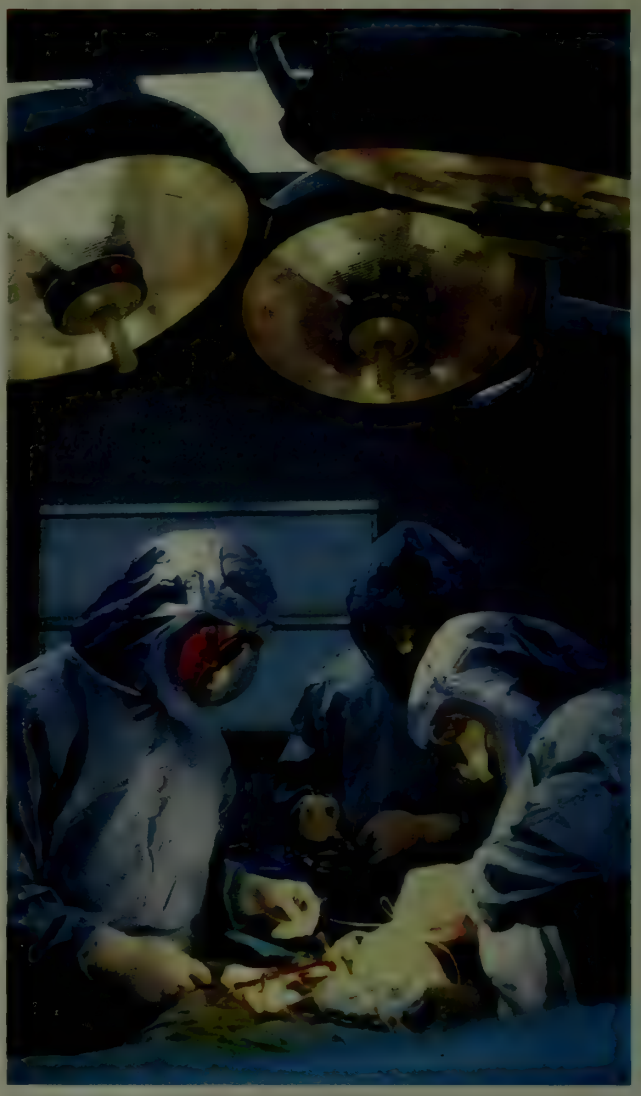
Rising costs and shrinking revenues are crimping growth

Until recently, for-profit hospitals have been hyped as the can't-miss business opportunity of the 21st century. With 75 million aging baby boomers about to depend on the health-care system, hospital executives spent the 1990s promising that the demand for such high-ticket procedures as knee replacements and heart surgeries would skyrocket. All the while, hospitals would cut costs by consolidating hundreds of independent players into superefficient chains that could churn out double-digit earnings growth year after year.

Turns out for-profit hospitals aren't quite such earnings machines. Analysts predict average earnings before taxes and other charges for the eight publicly traded hospital chains will drop 10% this year. True, much of the sorry performance is a result of Santa Barbara (Calif.)-based Tenet Healthcare Corp., which revised its pricing practices after admitting it achieved much of its past growth by exploiting a Medicare loophole. Excluding Tenet, the for-profit hospital industry should grow 9.5%. That may not sound so bad, but it is a far cry from last year's 17% growth rate.

Indeed, when Tenet announced on June 23 that earnings for the year ending July, 2004, would be as much as 30% less than analysts' already lowered expectations, it cited unexpected costs and pressures largely unrelated to accounting. The same factors are dogging Nashville-based HCA, which already paid $1.7 billion in fines to settle federal fraud charges, but still announced first-quarter earnings that were half of what analysts expected.

Tenet's warning of weaker earnings reflects a host of troubling trends afflicting the entire for-profit hospital sector. Overall patient admissions fell 1% in the first quarter of this year—the first drop in more than five years. That follows first-quarter increases of 1.5% in 2002 and 4.6% in 2001. The relentless nursing shortage, plus pressure from labor unions, is forcing some hospitals to boost salaries at record rates. And as they face protests from private health plans, and looming Medicare reform, hospitals are losing much of their pricing power. "There is a fundamental shift of power away from hospitals," says Sheryl Skolnick, analyst at research firm Fulcrum Global Partners LLC. "It's a shock to the system."



KNEE REPLACEMENT IN NASHVILLE: *Boomers were expected to drive growth, but admissions have fallen*

For the past five years, for instance, hospitals have foisted average price increases of 6% per year onto health plans, without much resistance. Now insurers are fighting back. WellPoint Health Networks Inc., the nation's second-largest insurer, collects data compari treatment success w prices. If one hospi charges $1,000 to set a b ken arm, for example, bu neighboring hospital t charges $500 has as ma satisfied patients, WellPo uses the data to negoti lower rates from the pric hospital.

Hospitals are also suff ing from unexpectedly h labor costs. The Serv Employees Internatio Union, the nation's larg health-care workers uni has added 10 HCA and Te hospitals to its ranks si December—more for-pr hospitals than it mobili in the past two years c bined. At one such facil Tenet's Daniel Freem Memorial Hospital in Ing wood, Calif., nurses w guaranteed salary incre es of up to 29% over next four years. "Some them have never recei raises that were that hi Ever," says SEIU spokesp son Lisa Hubbard.

Such added costs wo be less damaging to the dustry's bottom line if r enues were growing a healthy clip. But the rec drop in patient admission a troubling sign that ho tals may be more vulnerable to econ ic declines than they claim to be. S baby boomers are getting older, but a lysts fear potential patients are delay such elective procedures as knee placements because they've lost th jobs or are afraid to take time off fr work. That's bad news for the major h pital chains, which have been spending new equipment to spruce up orthope centers and other services geared to ing patients.

For-profit hospitals are working h to live up to their earlier promises. M are deploying new computer systems streamline payment systems and ot administrative tasks. That could cut c in the long run. But the fundamen challenges remain. Hospital chains n be doomed to trudging along at sin digit rates, rather than recapturing speedier growth they once boasted. investors hoping for so much more, th a disappointing prognosis.

By Arlene Weintraub in Los Ang and Charles Haddad in Atlanta

Pass the Aspirin, Please

Hospital chains have taken a beating

FOUR LARGEST HOSPITAL COMPANIES BY REVENUES	STOCK PRICE*	YEAR-TO-DATE RETURN
HCA	$31.95	–23%
TENET HEALTHCARE	11.45	–30
TRIAD HOSPITALS	24.41	–18
UNIVERSAL HEALTH	39.76	–12

*As of July 1 Data: Bloomberg Financial Markets

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RETAILING

CALL IT MALL-MART

As anchor department stores fail, big discounters move in

In a world where too many shops are chasing too few shoppers, retailers are always hunting for ways to tap new customers. Just ask Wal-Mart Stores Inc. While it's staking most of its growth on massive, stand-alone supercenters, Wal-Mart recently opened a two-story store in a Massapequa (N.Y.) mall, about 20 miles from New York City. And in January, it opened a three-story unit in a Los Angeles mall where a Macy's department store once operated. For the first time, Wal-Mart is even building its own addition to a regional mall, this one near San Diego.

Wal-Mart at the mall—once the province of department stores and specialty shops? Those days are long gone, and Wal-Mart isn't the only discounter that sees opportunity where much of America shops. Target Corp. has been experimenting with discount stores in malls for 25 years. Now, it has more than 30 such units, most of which it picked up from Montgomery Ward in 2001. And Minneapolis-based Target appears poised to pick up the pace. Goldman, Sachs & Co. analyst George Strachan figures Target could have 150 mall stores by 2012.

Why the sudden rush to the mall? Mostly the discounters see it as a way to enter densely populated urban and suburban markets with minimal hassle. Strachan estimates that as many as 800 anchor spots in malls could turn over in the next decade—with discounters snapping up 300 of them. "This is an incremental, opportunistic strategy to continue to fill in markets," says Lois Huff, senior vice-president at Retail Forward Inc., a Columbus (Ohio) consultancy.

While the shopping mall doesn't fit the discounters' traditional mold—single-story units with acres of parking—it's easy to see the allure. In some cases, it's the only way these retailers can find enough space in the cities. "Most often, what's available in an affordable price range is something that someone else left behind," says Robert S. McAdam, a Wal-Mart vice-president who's in charge of winning local government approval for new stores.

And these well-established re sites, with parking, lighting, and ot infrastructure, can help the big- stores avoid the neighborhood out and zoning battles that often accom ny their expansion. While healthy s are the ultimate goal, it's a nice for Wal-Mart to be welcomed as economic savior in places such as P land, Ore., and Los Angeles, where presence is helping to revive once- minal malls that serve primarily nority shoppers.

It's impossible to assess the p itability of discounters' mall-ba stores, because they don't break those numbers. But analyst Strac figures real estate costs are about e to what they would pay for free-sta ing stores. Logistics cost more, beca unloading and moving in the merch dise is less efficient than at stand-a stores. But analysts say those c are probably offset by higher st traffic and better sales per square

Of course, there are some tricky erational challenges. Retailers ac tomed to one-level stores have to configure the layout to move shop through the multi-floor locations. can mean transporting shopping c on special escalators; in its Baldwin store in Los Angeles, Wal-Mart als stalled a special elevator to move food to the right section of the st But the company is quickly lear how to handle nontraditional store mats, thanks in part to its experi with multistory units overseas.

Mall retailers and owners gene

NOW IN SUBURBAN SHOPPING CENTERS

HEADING TO THE MALL

DISCOVERING THE BENEFITS . . .

- Access to densely popula ed markets in areas wher real estate is scarce
- Good deals from mall own ers keen to fill empty spac
- Fewer battles with "sprawl" opponents

. . . AND THE DRAWBACK

- Higher costs for logistics and security
- Switching from the tradi- tional single-floor layout t several floors is proving diffic

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welcome the discount lions into their dens. As department stores have shed customers in recent years, many malls have suffered financially. "If Target is going to locate [nearby]," says Richard S. Sokolov, president of mall developer Simon Property Group Inc., "we might as well get the advantage of their market share and sales and advertising within our property, as opposed to across the street."

As with Sears Roebuck and J.C. Penney, Federated Department Stores Inc. says it's not afraid of discount interlopers. Indeed, Federated sold Wal-Mart the lease in the Massapequa mall. It continues to operate a Macy's at that shopping center. The department stores like the extra traffic too—and the discounters also offer commodities and hard goods that they don't.

MALL CHANGE: *Once a Mac*

At the very least, the ne comers might "slow dow the death rates of some partment stores, predicts tail consultant Burt Flickinger III of Strategic source Group. In the bru world of retailing, that's as close as get to a win-win proposition.

By Wendy Zellner in Da

BAR CODES BETTER WATCH THEIR BACKS

New retail technologies have a way of lingering in dreamland until discount colossus Wal-Mart decides it's time for everyone to wake up. The alarm clock in Bentonville, Ark., just went off again, this time for a successor to bar codes called Radio Frequency Identification (RFID). The wireless technology aims for a world where shelves are always full, supply chains hum efficiently, and consumers are bombarded with promotions as they shop.

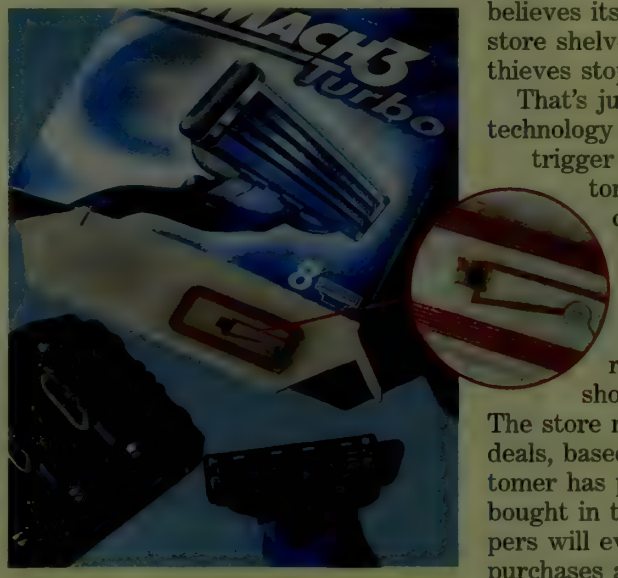
The wake-up call came from Wal-Mart Stores Inc.'s Chief Information Officer Linda Dillman. She recently announced that the megaretailer will require its 100 top suppliers to start using RFID for some applications by January, 2005. Given Wal-Mart's enormous size and influence, the technology could spread quickly: Not only will other retailers be forced to adopt it to remain competitive, the wider use will also bring down installment costs. "A lot of people don't want to be the first in the water," says Kevin Ashton, head of the Auto-ID Center, a consortium that is developing RFID. "But one Wal-Mart is worth 101 other companies."

So what is RFID? The postage-stamp-size tags combine tiny chips with an antenna. When a tag is placed on an item, it automatically radios its location to readers on loading bay doors, store shelves, or shopping carts. The tags are also linked to computer networks, where inventory data are stored. That might include when and where a specific item was made, its color or size, and at what temperature it should be stored.

RFID could drastically cut costs and smooth out bumps in the supply chain. Because the tags automatically transmit information to a network, warehouse staff and store clerks would no longer have to swipe each item with a bar code reader when taking inventory or toting up a customer's sales. That means fewer staff and lower costs. According to Sanford C. Bernstein & Co. analyst Emme P. Kozloff, Wal-Mart could save $8.4 billion a year by 2007 by installing RFID in many of its operations. The technology even promises to reduce theft: When large numbers of an item are removed from shelves RFID will alert employees.

Just as important, companies will have an instant read on inventory. That means retailers and suppliers can respond quickly to shifts in demand, avoid spoilage, and prevent over- and understocking. British grocery chain Tesco and Gillette are testing RFID in Cambridge. Gillette believes its sales could jump 15% if store shelves are always stocked and thieves stopped.

That's just for starters. As the technology blossoms, RFID tags will trigger in-store promotions. Customers may swipe a discount card through an RFID reader attached to their shopping cart, for example. The store may then offer special deals, based on tagged items the customer has put in the cart or what he bought in the past. Eventually, shoppers will even be able to ring up purchases as they put them in the RFID-equipped cart.



DON'T STEAL THIS RAZOR
A Gillette tracking tag

None of this will happen overnight. Tags now run about 10¢ apiece, and won't be feasible until they're under a penny. Tech glitches such as radio interference also could delay implementation. And companies will have to convince consumers that the tags are not a threat to personal privacy. With Wal-Mart pushing RFID, however, retailers and consumers will be grappling with these issues far sooner than anyone had imagined.

By Gerry Khermouch and Heathe Green in New York, with bureau reports

RADIO FREQUENCY ID

Tiny tags track products from factory to store. How it works:

MANUFACTURERS

Automatically counts inventory, which means fewer employees and faster response to shifts in demand.

RETAILERS

Will help keep shelves full, thwart shoplifters, and facilitate automatic checkout. Can also track buying patterns and bombard shoppers with promotions.

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In Business This Week

EDITED BY MONICA ROMAN

HEED ANALYSTS AT YOUR OWN RISK

LET THE INVESTOR BEWARE. That was the message sent by two district court judges on July 1 in the first major cases about research since Wall Street's largest firms agreed in April to pay $1.4 billion to settle charges about research conflicts of interest. U.S. District Judge Harold Baer dismissed claims that research analysts at Goldman Sachs, Credit Suisse First Boston, and Morgan Stanley deceived investors about the prospects for Covad Communications Group. Meanwhile, Southern District of New York Judge Milton Pollack granted Merrill Lynch's motion to dismiss class actions related to the stocks of 24/7 Real Media Inc. and Interliant Inc. He dismissed claims that former Merrill Lynch star analyst Henry Blodget caused investor losses. "Plaintiffs brought their own losses upon themselves when they knowingly spun an extremely high-risk, high-stakes wheel of fortune," Pollack wrote.

VERIZON: SEE YOU IN WIRELESS COURT

WIRELESS PHONE COMPETITION is getting rough. On June 27, Verizon Wireless filed suit against rival Nextel Communications, alleging that Nextel had illegally obtained test models of a new Verizon phone. Verizon alleges that Nextel used "illegal corporate espionage" to obtain the devices, which will compete with Nextel's popular walkie-talkie-like service. The suit, which seeks compensation and punitive damages, doesn't explain how Nextel allegedly obtained the phones. Nextel said it was baffled by the complaint, filed in U.S. District Court in Alexandria, Va. Nextel's service has been hugely successful, and Verizon and other carriers are expected to roll out similar offerings this year.

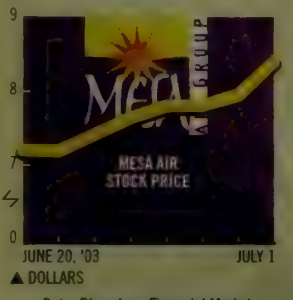
CALLAWAY SCOOPS UP AN AILING RIVAL

FORE! CALLAWAY GOLF, MAKER of beloved Big Bertha clubs, is acquiring Top-Flite Golf out of bankruptcy for $125 million. Long the leader in value-priced golf balls, Top-Flite struggled under a heavy debt load assumed by parent Spalding Sports Worldwide after a 1996 leveraged buyout. Top-Flite's financial problems were compounded by the late-1990s golf ball wars, which saw new players, such as Nike, Adidas, and Callaway, enter the market just as demand hit a rough patch. Callaway will consolidate Top-Flite with its ball and club research and manufacturing operations, taking charges of $70 million this year.

CLOSING BELL

WINGING AWAY

Mesa Air took off after it signed a tentative 10-year pact to become a full-fledged feeder carrier for United Airlines. Under the deal, Mesa would fly 35 to 60 United Express jets in addition to the 10 prop planes it now flies for United. Mesa shares gained 6%, to close at $8.42 on July 1.



Data: Bloomberg Financial Markets

HEADLINER: ALAN MULALLY

BLUER SKIES

A week after European rival Airbus bagged about 60 new orders at the Paris Air Show, Boeing Commercial Airplanes CEO Alan Mulally finally has something to smile about. His Seattle-based airplane unit on July 1 landed a multi-billion-dollar order with AirTran Airways to build up to 110 Boeing narrowbody jets.

The Orlando-based discount carrier ordered 28 737s, which can seat 120 to 190 passengers, will lease 22, and took options for 50 more. The carrier also ordered 10 717s—Boeing's smallest commercial jet, with 100 seats. The total contract is worth about $ billion at list prices, but airplanes are usually sold at a discount. Equally i portant for Mulally, the AirTran deal closes the gap wi Airbus, which ha had a strong lea in orders this ye Airbus had airplane orders for 2 aircraft by June 30, while Boeing counted orders, not including the AirTran business.

With Boeing's board ex pected to decide soon whether to build the 7E7 Dreamliner, a superefficie widebody aircraft, the Ai Tran deal makes Mulally' efforts to launch a big ne airplane just a bit easier.

Stanley Holm

JUSTICE TO ORACLE: NOT SO FAST

JUSTICE DEPT. ANTITRUST watchdogs have all but guaranteed that Oracle's $6.3 billion hostile takeover of PeopleSoft won't close anytime soon. On June 30, Justice asked Oracle about the deal's impact on competition in the corporate-software market, where Oracle and PeopleSoft rank second and third, respectively. Despite Justice's request and a separate antitrust lawsuit filed by the state of Connecticut, Oracle said it believes the deal will be approved. Oracle has set a July 7 deadline for its all-cash $19.50 a share offer, but it may extend the date.

SHAREHOLDERS WIN A SAY IN EXEC OPTIONS

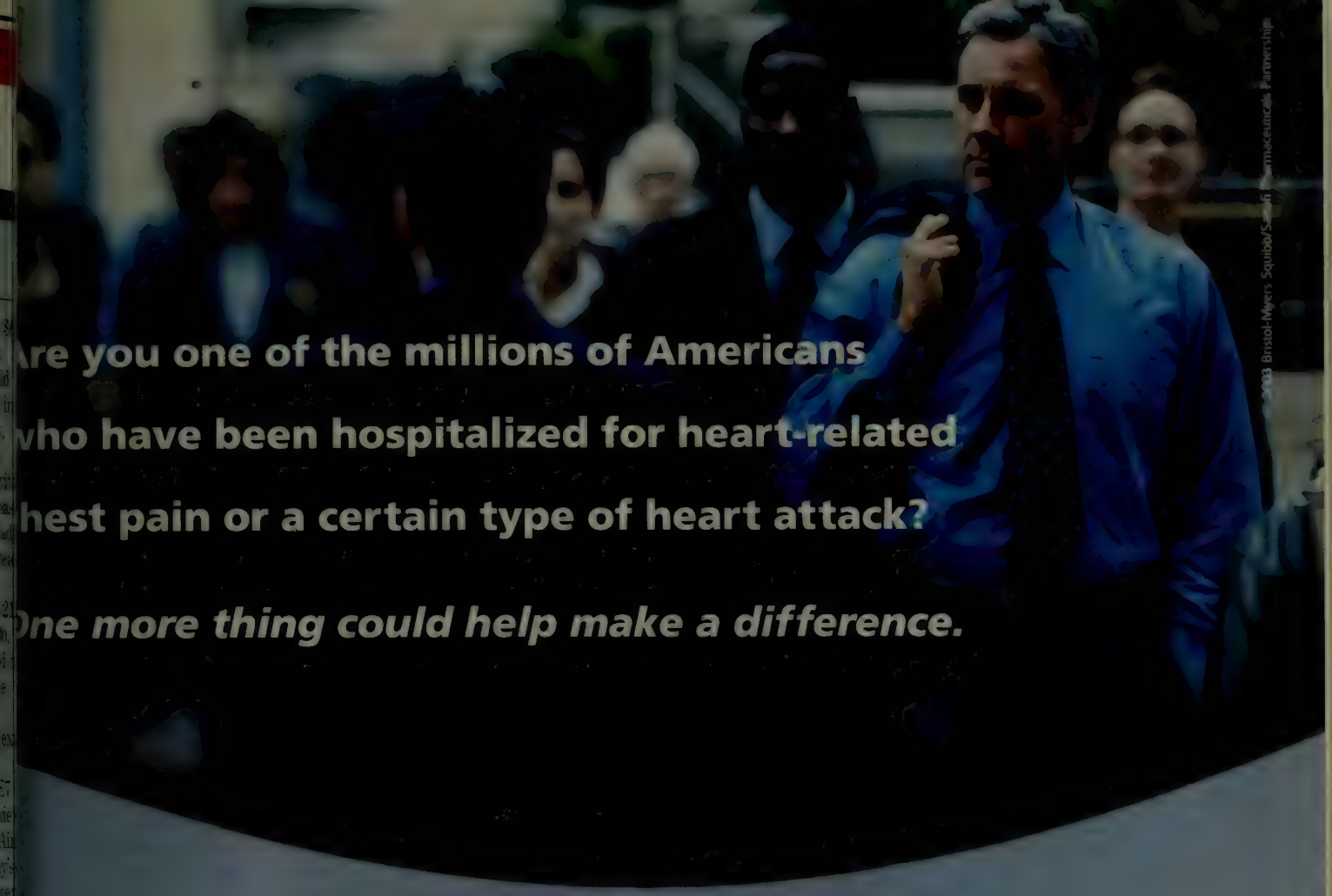
IN A VICTORY FOR INVESTOR advocates, the Securities & Exchange Commission on June 30 ruled that companies r obtain shareholder appr before granting stock opt and other equity compensa to executives and employ The new rules apply to c panies on the New York S Exchange and the NAS The SEC effectively close Big Board loophole that allowed companies to a shareholder votes if com sation plans included opt grants for lower-level emp ees. The SEC also said companies must get sh holders' O.K. to change exercise price of options.

ET CETERA . . .

■ As obesity concerns g Kraft Foods on July 1 pr ised to cap portion sizes.

■ American Airlines is la off 3,100 flight attendants.

■ MGM, Viacom, NBC, Lib Media, and Edgar Bronf Jr. made a second cut to for Vivendi's Hollywood as



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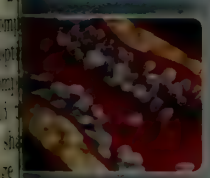
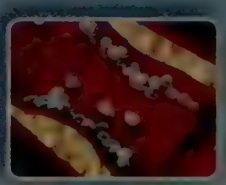
AVIX,® added to aspirin and your current edications, helps raise your protection against ture heart attack or stroke. If you've been spitalized for heart-related chest pain or a certain pe of heart attack, what doctors call ACS (Acute oronary Syndrome), ask your doctor about ding PLAVIX.



The platelets in your blood can form clots. These clots may block the flow of blood to the heart or brain. Think aspirin and ur other medications alone are enough? Adding AVIX could help protect you against a future art attack or stroke.



PLAVIX and your other medications work in different ways. Adding PLAVIX can go beyond your current treatment. Prescription PLAVIX, taken with aspirin, plays its own role in keeping platelets from sticking together and forming clots—which helps keep blood flowing.

Talk to your doctor about PLAVIX.
For more information, visit
www.plavix.com or call 1-888-440-6899.

ONCE-A-DAY
Plavix®
(clopidogrel bisulfate) 75mg tablets

Add more protection against heart attack or stroke

PORTANT INFORMATION: If you have a medical condition that causes bleeding, such as stomach ulcer, u shouldn't use PLAVIX. The risk of bleeding may increase with PLAVIX, and when you take PLAVIX ith certain other medicines, including aspirin. Review your medicines with your doctor to minimize this k. Additional rare, but serious, side effects could occur.

ease see important product information on the following page.

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PLAVIX®

clopidogrel bisulfate tablets

BRIEF SUMMARY— Please see package insert for full prescribing information.

INDICATIONS AND USAGE: PLAVIX (clopidogrel bisulfate) is indicated for the reduction of thrombotic events as follows:

- **Recent MI, Recent Stroke or Established Peripheral Arterial Disease**
  For patients with a history of recent myocardial infarction (MI), recent stroke, or established peripheral arterial disease. PLAVIX has been shown to reduce the rate of a combined endpoint of new ischemic stroke (fatal or not), new MI (fatal or not), and other vascular death.
- **Acute Coronary Syndrome**
  For patients with acute coronary syndrome (unstable angina/non-Q-wave MI) including patients who are to be managed medically and those who are to be managed with percutaneous coronary intervention (with or without stent) or CABG. PLAVIX has been shown to decrease the rate of a combined endpoint of cardiovascular death, MI, or stroke as well as the rate of a combined endpoint of cardiovascular death, MI, stroke, or refractory ischemia.

CONTRAINDICATIONS: The use of PLAVIX is contraindicated in patients with a hypersensitivity to the drug substance or any component of the product, and those with active pathological bleeding such as peptic ulcer or intracranial hemorrhage.

WARNINGS: *Thrombotic thrombocytopenic purpura (TTP):* TTP has been reported rarely following use of PLAVIX, sometimes after a short exposure (<2 weeks). TTP is a serious condition requiring prompt treatment. It is characterized by thrombocytopenia, microangiopathic hemolytic anemia (schistocytes [fragmented RBCs] seen on peripheral smear), neurological findings, renal dysfunction, and fever. TTP was not seen during clopidogrel's clinical trials, which included over 17,500 clopidogrel-treated patients in world-wide postmarketing experience, however TTP has been reported at a rate of about four cases per million patients exposed, or about 11 cases per million patient-years. The background rate is thought to be about four cases per million person-years.

PRECAUTIONS: General: As with other antiplatelet agents, PLAVIX prolongs the bleeding time and therefore should be used with caution in patients who may be at risk of increased bleeding from trauma, surgery, or other pathological conditions (particularly gastrointestinal and intraocular). If a patient is to undergo elective surgery and an antiplatelet effect is not desired, PLAVIX should be discontinued 5 days prior to surgery. Due to the risk of bleeding and undesirable hematological effects, blood cell count determination and/or other appropriate testing should be promptly considered, whenever such suspected clinical symptoms arise during the course of treatment (see ADVERSE REACTIONS). *GI Bleeding:* In CAPRIE, PLAVIX was associated with a rate of gastrointestinal bleeding of 2.0%, vs. 2.7% on aspirin. In CURE, the incidence of major gastrointestinal bleeding was 1.3% vs. 0.7% (PLAVIX + aspirin vs. placebo + aspirin, respectively). PLAVIX should be used with caution in patients who have lesions with a propensity to bleed (such as ulcers). Drugs that might induce such lesions should be used with caution in patients taking PLAVIX. *Use in Hepatically Impaired Patients:* Experience is limited in patients with severe hepatic disease who may have bleeding diatheses. PLAVIX should be used with caution in this population. *Use in Renally-Impaired Patients:* Experience is limited in patients with severe renal impairment. PLAVIX should be used with caution in this population.

Information for Patients: Patients should be told that it may take them longer than usual to stop bleeding when they take PLAVIX, and that they should report any unusual bleeding to their physician. Patients should inform physicians and dentists that they are taking PLAVIX before any surgery is scheduled and before any new drug is taken.

Drug Interactions: Study of specific drug interactions yielded the following results. *Aspirin:* Aspirin did not modify the clopidogrel-mediated inhibition of ADP-induced platelet aggregation. Concomitant administration of 500 mg of aspirin twice a day for 1 day did not significantly increase the prolongation of bleeding time induced by PLAVIX. PLAVIX potentiated the effect of aspirin on collagen-induced platelet aggregation. PLAVIX and aspirin have been administered together for up to one year. *Heparin:* In a study in healthy volunteers, PLAVIX did not necessitate modification of the heparin dose or alter the effect of heparin on coagulation. Coadministration of heparin had no effect on inhibition of platelet aggregation induced by PLAVIX. *Nonsteroidal Anti-Inflammatory Drugs (NSAIDs):* In healthy volunteers receiving naproxen, concomitant administration of PLAVIX was associated with increased occult gastrointestinal blood loss. NSAIDs and PLAVIX should be coadministered with caution. *Warfarin:* The safety of the coadministration of PLAVIX with warfarin has not been established. Consequently, concomitant administration of these two agents should be undertaken with caution. (See **Precautions–General.**) *Other Concomitant Therapy:* No clinically significant pharmacodynamic interactions were observed when PLAVIX was coadministered with **atenolol, nifedipine**, or both atenolol and nifedipine. The pharmacodynamic activity of PLAVIX was also not significantly influenced by the coadministration of **phenobarbital, cimetidine or estrogen.** The pharmacokinetics of **digoxin** or **theophylline** were not modified by the coadministration of PLAVIX (clopidogrel bisulfate). At high concentrations *in vitro*, clopidogrel inhibits P_{450} 2C9. Accordingly, PLAVIX may interfere with the metabolism of **phenytoin, tamoxifen, tolbutamide, warfarin, torsemide, fluvastatin** and many **non-steroidal anti-inflammatory agents**, but there are no data with which to predict the magnitude of these interactions. Caution should be used when any of these drugs is coadministered with PLAVIX. In addition to the above specific interaction studies, patients entered into clinical trials with PLAVIX received a variety of concomitant medications **including diuretics, beta-blocking agents, angiotensin converting enzyme inhibitors, calcium antagonists, cholesterol lowering agents, coronary vasodilators, antidiabetic agents (including insulin), antiepileptic agents, hormone replacement therapy, heparins** (unfractionated and LMWH), and **GPIIb/IIIa antagonists** without evidence of clinically significant adverse interactions. The use of oral anticoagulants, non-study anti-platelet drug and chronic NSAIDs was not allowed in CURE and there are no data on their concomitant use with clopidogrel.

Drug/Laboratory Test Interactions: None known.

Carcinogenesis, Mutagenesis, Impairment of Fertility: There was no evidence of tumorigenicity when clopidogrel was administered for 78 weeks to mice and 104 weeks to rats at dosages up to 77 mg/kg per day, which afforded plasma exposures >25 times that in humans at the recommended daily dose of 75 mg. Clopidogrel was not genotoxic in four *in vitro* tests (Ames test, DNA-repair test in rat hepatocytes, gene mutation assay in Chinese hamster fibroblasts and metaphase chromosome analysis of human lymphocytes) and in one *in vivo* test (micronucleus test by oral route in mice). Clopidogrel was found to have no effect on fertility of male and female rats at oral doses up to 400 mg/kg per day (52 times the recommended human dose on a mg/m² basis).

Pregnancy: Pregnancy Category B. Reproduction studies performed in rats and rabbits at doses up to 500 and 300 mg/kg/day (respectively, 65 and 78 times the recommended daily human dose on a mg/m² basis), revealed no evidence of impaired fertility or fetotoxicity due to clopidogrel. There are, however, no adequate and well-controlled studies in pregnant women. Because animal reproduction studies are not always predictive of a human response, PLAVIX should be used during pregnancy only if clearly needed.

Nursing Mothers: Studies in rats have shown that clopidogrel and/or its metabolites are excreted in the milk. It is not known whether this drug is excreted in human milk. Because many drugs are excreted in human milk and because of the potential for serious adverse reactions in nursing infants, a decision should be made whether to discontinue nursing or to discontinue the drug, taking into account the importance of the drug to the nursing woman.

Pediatric Use: Safety and effectiveness in the pediatric population have not been established.

ADVERSE REACTIONS: PLAVIX has been evaluated for safety in more than 17,500 patients, including over 9,000 patients treated for 1 year or more. The overall tolerability of PLAVIX in CAPRIE was similar to that of aspirin regardless of age, gender and race, with an approximately equal incidence (13%) of patients withdrawing from treatment because of adverse reactions. The clinically important adverse events observed in CAPRIE and CURE are discussed below.

Hemorrhagic: In CAPRIE patients receiving PLAVIX, gastrointestinal hemorrhage occurred at a rate of 2.0%, and required hospitalization in 0.7%. In patients receiving aspirin, the corresponding rates were 2.7% and 1.1%, respectively. The incidence of intracranial hemorrhage was 0.4% for PLAVIX compared to 0.5% for aspirin.

In CURE, PLAVIX use with aspirin was associated with an increase in bleeding compared to placebo with aspirin (see Table 3). There was an excess in major bleeding in patients receiving PLAVIX plus aspirin compared with placebo plus aspirin, primarily gastrointestinal and at puncture sites. The incidence of intracranial hemorrhage (0.1%), and fatal bleeding (0.2%), was the same in both groups.

In patients receiving both PLAVIX and aspirin in CURE, the incidence of bleeding is described below.

CURE Incidence of bleeding complications (% patients)

Event	PLAVIX (+ aspirin)* (n=6259)	Placebo (+ aspirin)* (n=6303)	P-value
Major bleeding†	3.7‡	2.7§	0.001
Life-threatening bleeding	2.2	1.8	0.13
Fatal	0.2	0.2	
5 g/dL hemoglobin drop	0.9	0.9	
Requiring surgical intervention	0.7	0.7	
Hemorrhagic strokes	0.1	0.1	
Requiring inotropes	0.5	0.5	
Requiring transfusion (≥4 units)	1.2	1.0	
Other major bleeding	1.6	1.0	0.004
Significantly disabling	0.4	0.1	
Intracuular bleeding with significant loss of vision	0.05	0.03	
Requiring 2-3 units of blood	1.3	0.9	
Minor bleeding¶	5.1	2.4	<0.001

* Other standard therapies were used as appropriate.
† Life threatening and other major bleeding
‡ Major bleeding event rate for PLAVIX + aspirin was dose-dependent on aspirin: <100 mg=2.6%, 100-200 mg=3.5%, >200 mg=4.9%
§ Major bleeding event rate for placebo + aspirin was dose-dependent on aspirin: <100 mg=2.0%, 100-200 mg=2.3%, >200 mg=4.0%
¶ Led to interruption of study medication

Ninety-two percent (92%) of the patients in the CURE study received heparin/LMWH, and the rate of bleeding in these patients was similar to the overall results.

There was no excess in major bleeds within seven days after coronary bypass graft surgery in patients who stopped therapy more than five days prior to surgery (event rate 4.4% PLAVIX + aspirin, 5.3% placebo + aspirin). In patients who remained on therapy within five days of bypass graft surgery, the event rate was 9.6% for PLAVIX + aspirin, and 6.3% for placebo + aspirin.

Neutropenia/agranulocytosis: Ticlopidine, a drug chemically similar to PLAVIX, is associated with a 0.8% rate of severe neutropenia (less than 450 neutrophils/µL). In CAPRIE severe neutropenia was observed in six patients, four on PLAVIX and two on aspirin. Two of the 9599 patients who received PLAVIX and none of the 9586 patients who received aspirin had neutrophil counts of zero. One of the four PLAVIX patients in CAPRIE was receiving cytotoxic chemotherapy, and another recovered and returned to the trial after only temporarily interrupting treatment with PLAVIX (clopidogrel bisulfate). In CURE, the numbers of patients with thrombocytopenia (19 PLAVIX + aspirin vs. 24 placebo + aspirin) or neutropenia (3 vs. 3) were similar.

Although the risk of myelotoxicity with PLAVIX thus appears to be quite low, this possibility should be considered when a patient receiving PLAVIX demonstrates fever or other sign of infection.

Gastrointestinal: Overall, the incidence of gastrointestinal events (e.g., abdominal pain, dyspepsia, gastritis and constipation) in patients receiving PLAVIX (clopidogrel bisulfate) was 27.1%, compared to 29.8% in those receiving aspirin in the CAPRIE trial. In the CURE trial the incidence of these gastrointestinal events for patients receiving PLAVIX + aspirin was 11.7% compared to 12.5% for those receiving placebo + aspirin.

In the CAPRIE trial, the incidence of peptic, gastric or duodenal ulcers was 0.7% for PLAVIX and 1.2% for aspirin. In the CURE trial the incidence of peptic, gastric or duodenal ulcers was 0.4% for PLAVIX + aspirin and 0.3% for placebo + aspirin.

Cases of diarrhea were reported in the CAPRIE trial in 4.5% of patients in the PLAVIX group compared to 3.4% in the aspirin group. However these were rarely severe (PLAVIX=0.2% and aspirin=0.1%). In the CURE trial, the incidence of diarrhea for patients receiving placebo + aspirin was 2.1% compared to 2.2% for those receiving placebo + aspirin.

In the CAPRIE trial, the incidence of patients withdrawing from treatment because of gastrointestinal adverse reactions was 3.1% for PLAVIX and 4.0% for aspirin. In the CURE trial, the incidence of patients withdrawing from treatment because of gastrointestinal adverse reactions was 0.9% for PLAVIX + aspirin compared with 0.8% for placebo + aspirin.

Rash and Other Skin Disorders: In the CAPRIE trial, the incidence of skin and appendage disorders in patients receiving PLAVIX was 1.5% (0.7% serious), the corresponding rate in aspirin patients was 1.3% (0.5% serious). In the CURE trial the incidence of rash or other skin disorders in patients receiving PLAVIX + aspirin was 4.0% compared to 3.5% for those receiving placebo + aspirin.

In the CAPRIE trial, the overall incidence of patients withdrawing from treatment because of skin and appendage disorders adverse reactions was 1.5% for PLAVIX and 0.8% for aspirin. In the CURE trial, the incidence of patients withdrawing because of skin and appendage disorders adverse reactions was 0.7% for PLAVIX + aspirin compared with 0.3% for placebo + aspirin.

Adverse events occurring in ≥2.5% of patients on PLAVIX in the CAPRIE controlled clinical trial are shown below regardless of relationship to PLAVIX. The median duration of therapy was 20 months, with a maximum of 3 years.

Adverse Events Occurring in ≥2.5% of PLAVIX Patients in CAPRIE

Body System / Event	% Incidence (% Discontinuation) PLAVIX (n=9599)		Aspirin (n=9586)	
Body as a Whole — general disorders				
Chest Pain	8.1	(0.2)	8.3	(0.4)
Accidental/Inflicted Injury	7.9	(0.1)	7.3	(0.1)
Influenza-like symptoms	7.5	(<0.1)	7.0	(<0.1)
Pain	6.4	(0.1)	6.3	(0.1)
Fatigue	3.3	(0.1)	3.3	(0.1)
Cardiovascular disorders, general				
Edema	4.1	(<0.1)	4.5	(<0.1)
Hypertension	4.3	(<0.1)	5.1	(<0.1)
Central & peripheral nervous system disorders				
Headache	7.6	(0.3)	7.2	(0.2)
Dizziness	6.2	(0.2)	6.7	(0.3)
Gastrointestinal system disorders				
Abdominal pain	5.6	(0.7)	7.1	(1.0)
Dyspepsia	5.2	(0.6)	5.1	(0.7)
Diarrhea	4.5	(0.6)	5.0	(0.8)
Nausea	3.4	(0.5)	3.8	(0.4)
Metabolic & nutritional disorders				
Hypercholesterolemia	4.0	(0)	4.4	(<0.1)
Musculo-skeletal system disorders				
Arthralgia	6.1	(0.1)	6.2	(0.1)
Back Pain	5.6	(0.1)	5.3	(<0.1)
Platelet, bleeding, & clotting disorders				
Purpura/Bruise	5.3	(0.3)	3.7	(0.1)
Epistaxis	2.9	(0.2)	2.5	(0.1)
Psychiatric disorders				
Depression	3.6	(0.1)	3.6	(0.2)
Respiratory system disorders				
Upper resp tract infection	8.7	(<0.1)	8.8	(<0.1)
Dyspnea	4.5	(0.1)	4.7	(0.1)
Rhinitis	4.2	(0.1)	4.2	(<0.1)
Sinusitis	3.7	(0.1)	3.7	(0)
Coughing	3.1	(<0.1)	2.7	(<0.1)
Skin & appendage disorders				
Rash	4.2	(0.5)	3.6	(0.2)
Pruritus	3.3	(0.3)	2.6	(0.1)
Urinary system disorders				
Urinary tract infection	3.1	(0)	3.0	(0.1)

Incidence of discontinuation, regardless of relationship to therapy, is shown in parentheses.

Adverse events occurring in ≥2.0% of patients on PLAVIX in the CURE controlled clinical trial are shown below regardless of relationship to

Adverse Events Occurring in ≥2.0% of PLAVIX Patients in CURE

Body System / Event	% Incidence (% Discontinuation) PLAVIX (+ aspirin)* (n=6259)		Placebo (+ aspirin)* (n=6303)	
Body as a Whole–general disorders				
Chest Pain	2.7	(<0.1)	2.1	(0.0)
Central & peripheral nervous system disorders				
Headache	3.1	(0.1)	3.2	(0.1)
Dizziness	2.4	(0.1)	2.0	(<0.1)
Gastrointestinal system disorders				
Abdominal pain	3.1	(0.3)	2.8	(0.3)
Dyspepsia	2.1	(0.1)	1.9	(<0.1)
Diarrhea	2.1	(0.1)	2.2	(0.1)

*Other standard therapies were used as appropriate.

Other adverse experiences of potential importance occurring in 1% to 2.5% of patients receiving PLAVIX (clopidogrel bisulfate) in CAPRIE or CURE controlled clinical trials are listed below regardless of relationship to PLAVIX. In general, the incidence of these events was similar to that in patients receiving aspirin (in CAPRIE) or placebo + aspirin (in CURE).

Autonomic Nervous System Disorders: Syncope, Palpitation. *Body as a Whole - general disorders:* Asthenia, Fever, Hernia. *Cardiac disorders:* Cardiac failure. *Central and peripheral nervous system disorders:* Cramps legs, Hypoaesthesia, Neuralgia, Paraesthesia. *Gastrointestinal system disorders:* Constipation, Vomiting. *Heart rate and rhythm disorders:* Fibrillation atrial. *Liver and biliary system disorders:* Hepatic enzymes increased. *Metabolic and nutritional disorders:* Gout, hyperuricemia, non-protein nitrogen (NPN) increased. *Musculo-skeletal system disorders:* Arthritis, Arthrosis. *Platelet, bleeding & clotting disorders:* GI hemorrhage, hematoma, platelets decreased. *Psychiatric disorders:* Anxiety, Insomnia. *Red blood cell disorders:* Anemia. *Respiratory system disorders:* Pneumonia, Sinusitis. *Skin & appendage disorders:* Eczema, Skin ulceration. *Urinary system disorders:* Cystitis. *Vision disorders:* Cataract, Conjunctivitis.

Other potentially serious adverse events which may be of clinical interest but were rarely reported (<1%) in patients who received PLAVIX in the CAPRIE or CURE controlled clinical trials are listed below regardless of relationship to PLAVIX. In general, the incidence of these events was similar to that in patients receiving aspirin (in CAPRIE) or placebo + aspirin (in CURE). *Body as a whole:* Allergic reaction, ischemic. *Cardiovascular disorders:* Edema generalized. *Gastrointestinal system disorders:* Gastric ulcer perforated, gastritis hemorrhagic, upper GI ulcer hemorrhagic. *Liver and Biliary system disorders:* Bilirubinemia, hepatitis infectious, liver fatty. *Platelet, bleeding and clotting disorders:* hemarthrosis, hematuria, hemoptysis, hemorrhage intracranial, hemorrhage retroperitoneal, hemorrhage of operative wound, pulmonary hemorrhage, purpura allergic, thrombocytopenia. *Red blood cell disorders:* Anemia aplastic, anemia hypochromic. *Reproductive disorders, female:* Menorrhagia. *Respiratory system disorders:* Hemothorax. *Skin and appendage disorders:* Bullous eruption, rash erythematous, rash maculopapular, urticaria. *Urinary system disorders:* Abnormal renal function, acute renal failure. *White cell and reticuloendothelial system disorders:* Agranulocytosis, granulocytosis, leukemia, leukopenia, neutrophils decreased.

Postmarketing Experience: The following events have been reported spontaneously from worldwide postmarketing experience. *Body as a whole:* hypersensitivity reactions, anaphylactoid reactions. *Central and Peripheral Nervous System disorders:* confusion, hallucinations, taste disorders. *Liver and Biliary system disorders:* abnormal liver function test, hepatitis (non-infectious). *Platelet, Bleeding and Clotting disorders:* cases of bleeding with fatal outcome (especially intracranial, gastrointestinal and retroperitoneal hemorrhage), agranulocytosis, aplastic anemia, pancytopenia, thrombotic thrombocytopenic purpura (TTP) – see WARNINGS, conjunctival, ocular and retinal bleeding. *Respiratory system disorders:* bronchospasm. *Skin and Appendage disorders:* angioedema, erythema multiforme. *Urinary system disorders:* glomerulonephritis, abnormal creatinine levels.

OVERDOSAGE: One case of deliberate overdosage with PLAVIX was reported in the large, CAPRIE controlled clinical study. A 34-year-old woman took a single 1,050-mg dose of PLAVIX (equivalent to 14 standard 75-mg tablets). There were no associated adverse events. Medicinal therapy was instituted, and she recovered without sequelae. No adverse events were reported after single oral administration of 300 mg (equivalent to 8 standard 75-mg tablets) of PLAVIX in healthy volunteers. The bleeding time was prolonged by a factor of 1.7, which is similar to that typically observed with the therapeutic dose of 75 mg of PLAVIX per day. A single oral dose of clopidogrel at 1500 or 2000 mg/kg was lethal to mice and to rats and at 3000 mg/kg to baboons. Symptoms of acute toxicity were vomiting (in baboons), prostration, labored breathing, and gastrointestinal hemorrhage in all species.

Recommendations About Specific Treatment: Based on biological plausibility, platelet transfusion may be appropriate to reverse the pharmacological effects of PLAVIX if quick reversal is required.

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ITED BY RICHARD S. DUNHAM

AN BUSH FINALLY FINISH OFF HE GREAT SOCIETY?

ith Republicans in control of both ends of Pennsylvania Avenue, it's not a great time for the Great Society. President George W. Bush and GOP leaders on Capitol ll are seeking to restructure some of the signature social ograms of the free-spending Golden Era of American Lib-lism to fit the cash-strapped Age of Compassionate Con-vatism. Among the mainstays targeted for overhaul: Head rt, Medicaid, and federal housing programs.

Reviving the rhetoric of Ronald Reagan's unfulfilled "New deralism" initiative, Bush and his allies want give governors more authority and flexibili- in administering social safety net programs. t while most governors are attracted to the ncept of "devolution"—as the Bush battle is called—many worry that Washington is t shifting responsibilities to them without aranteeing long-term support. The result, y fear: a series of huge unfunded mandates t would force politically risky decisions such raising taxes or cutting benefits.

"If there is a way to standardize and sim-fy these programs, that would be a plus," s Democratic Governor John E. Baldacci of ine. "At the same time, we have to be care- because when you shift these programs m [the federal government] to block grants, tes could be left holding the bag."

HEAD START: *First target*

Now under the congressional microscope is ad Start, the $6.7 billion program that provides nutrition, alth care, and early education to nearly 1 million low-income and 4-year-olds. Bush originally proposed giving governors np sums to serve the nation's poorest preschoolers. Propo-nts argue this would allow state officials to integrate Head rt into existing educational offerings. Georgia, which has a e-kindergarten program for all 4-year-olds, for example, uld be a prime candidate for a block grant. "If you can co-dinate Head Start with other state programs, poor children ll get more help," says moderate Representative Michael N. Castle (R-Del.), a former governor and sponsor of the bill.

Even opponents of devolution acknowledge that Head Start could be improved by focusing it more on early-childhood learning. But critics fear that cash-strapped states would simply divert block grants to other priorities.

The first skirmish in the devolution wars was won by Bush's armies of compassion, but at a price. Concluding that a wholesale revamp of Head Start was too radical, the House Education and the Workforce Committee on June 12 voted to allow eight governors whose states already offer pre-K services, like Georgia and New Jersey, to receive block grants to run their Head Start operations for five years.

While that's less than Bush had sought, friends and foes see it as a White House win. "They couldn't get a Head Start block granted this year, but...they've taken a major step toward doing just that," says Representative George Miller (D-Calif.), a leading critic. The Administration agrees. "We're very pleased with the House bill because it moves us in the direction of the President's vision," says Wade F. Horn, Health & Human Services Assistant Secretary for children and families.

The pilot project looks likely to pass in the GOP-dominated House, but Senators Ted Kennedy (D-Mass.) and Christopher J. Dodd (D-Conn.) vow to block it in the Senate. Under state control, they fear, Head Start will skimp on health and nutrition. The outcome, when the Senate considers the legislation this summer, remains uncertain.

But if the President wins a second term, he is almost sure to step up efforts to reshape more costly low-income assistance programs, including Medicaid, which provides health care to the poor and disabled, and federal housing. Four more years, and Reagan's deferred dream of shrinking the federal government could be realized by Bush.

By Alexandra Starr

CAPITAL WRAPUP

HE REAL PARTY OF FAT CATS

A new study by the nonpartisan enter for Responsive Politics con-rms Democrats' worst fears: They ely far more on fat cats than the Re-ublicans. Despite Democratic claims hat the GOP is the party of the rich, he analysis of more than 1.4 million ontributors in the 2002 election cycle hows Dems got 92% of million-dollar-lus checks—the kind now banned (un-ess the Supreme Court invalidates ampaign-finance reform later this year). Small, hard-money donors gave 64% of their money to Republicans.

The first evidence of the hard-money gap: In two weeks in late June, Bush is expected to have raised more than all nine Democratic Presidential hopefuls did in the past three months.

A silver lining for Dems: They may have a lucrative target in professional women. Income-earning women, the CRP study found, gave 61% of their money to Dems. Women who call themselves homemakers favored the GOP.

REVENGE ON THE NILE

▶ Having at least one developing nation on board—Egypt—was considered crucial when the Administration brought a WTO case against the European Union over its ban on new forms of genetically modified food. But under pressure from its major trading partner, Europe, Egypt has now dropped out, leaving the U.S., Argentina, and Canada as plaintiffs. Now, a seething White House has pointedly axed plans to negotiate a free-trade deal with Cairo.

IBM®

Ming Tsai, IBM business strategist, retail industry

The waggly bee dance and the responsive enterprise.

Upon arriving back at the hive, a bee with pollen-coated legs does a waggly dance for her fellow bees. The thorax motions are actually a map drawn in the air, entomologists have suggested, indicating both the direction and the distance of the pollen source.

This is the kind of "sense-and-respond" behavior that defines on demand business — the kind that most companies can only dream about.

A sense-and-respond retail environment, for instance, would know every time its best customers entered the store. It would be able to respond to what each valued customer was shopping for that day and suggest appropriate cross- and up-sells. Products would be in stock, promotions would be relevant, sales associates would be experts, checkout would be instantaneous.

This is on demand business, waggling to show you where the money is.

On demand business starts with on demand thinking.

Real people with real insights and the resources to deliver on them. Partners, listeners, problem solvers. Doers. People to help you evolve your thinking, your business and your culture. It won't happen overnight. It will, however, create real change in your company. On demand business. Get there with on demand people. Please call 800 IBM 7080 (ask for thinking) or visit **ibm.com**/services/thinking

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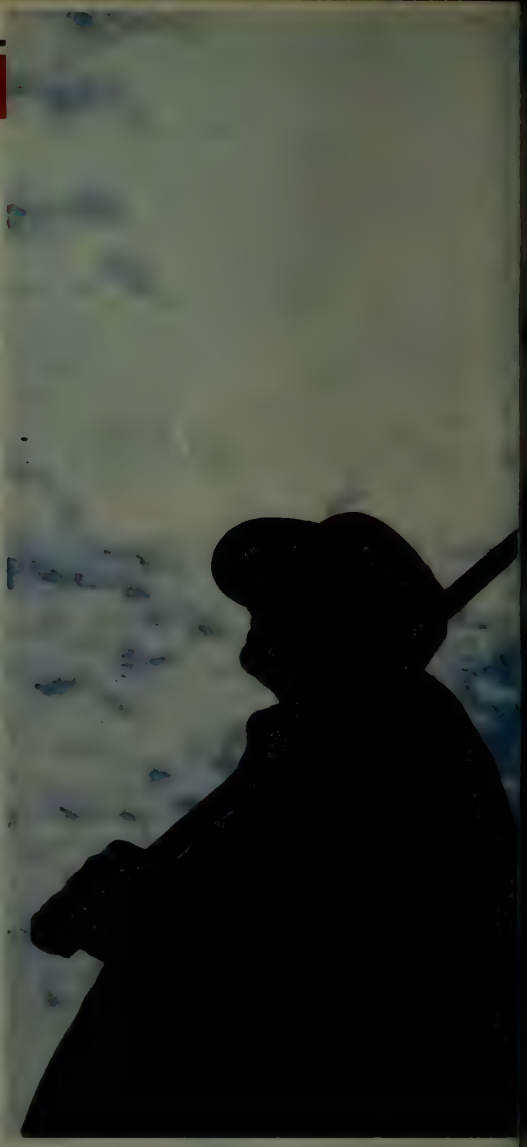
POLITICS

A NEW DEAL IN EUROPE?

With labor's power flagging, serious reforms may be around the corner



Labor leaders called it a gesture of solidarity, but many Germans saw it as an act of economic insanity. The militant IG Metall union last year demanded that auto, steel, and engineering workers in eastern Germany work the same 35 hours a week as their comrades in the West—a move that would have encouraged companies to flee across the border to Poland or other low-cost countries. When talks went nowhere, the union in June backed up its demand with strikes, forcing auto maker BMW, among others, to shut down some production lines.

Dumb move. Even some union members were appalled by the walkouts in a region that badly needs investment and where many companies are barely surviving. The public reaction was overwhelmingly negative, a sign that ordinary Germans have come to see unions not as defenders of the common man but as obstacles to urgently needed change. Even union members condemned the strikes by a margin of more than 2 to 1, according to a poll for broadcaster ZDF by Mannheim-based Elections Research Group. The debacle has already set off an internal power struggle that could bring a more moderate generation of labor leaders to the fore. And it follows earlier failure by the unions to derail labor-market reforms proposed by Chancellor Gerhard Schröder. "The unions are taking it on the chin everywhere," says John C. Kornblum, chairman of the German unit of investment bank Lazard Frères & Co. and former U.S. ambassador to Germany.

Germany isn't the only country where unions are feeling the sting of defeat. Left-wing labor defenders of the status quo have suffered serious setbacks recently in France and Italy, two other European countries where excess regulation smothers growth. In the past few weeks, France's center-right government faced down once-powerful unions to win the overhaul of the publicly financed pension system. And in Italy, voters rebuffed a union-backed effort to increase job protections. These suggest that voters in core Europe may finally be willing to accept rollbacks in the cherished welfare state to get the region's stagnant economy rolling again.

SUCCESS: *Raffarin gained support for a pension overhaul*

The big question is whether the politicians can seize the moment. They're under more pressure than ever. Germany's economy will shrink 0.1% this year, according to the Berlin-based German Institute for Economic Research, while the euro zone will grow only 0.5%. German Chancellor Schröder seems to have realized that his political survival depends on boosting growth and is showing new zeal for reform. "We know that people expecting us to provide a signal," told reporters June 29 as his gove ment backed a proposal to push ward planned income-tax cuts to s consumer spending. That follows forms proposed by Schröder in Ma dubbed Agenda 2010, that would m it easier for companies to hire and while trimming jobless, health, and p sion benefits. Schröder and Wolfg Clement, the popular Economics & bor Minister, have even been discuss lengthening the workweek, pushing b retirement age, and reducing holida

The big question: Ca

Of course, even if all the reforms through, Germans and French will work less than Americans or Brit and enjoy more generous benefits. S the signs are clear that Europeans h begun swinging away from reflexive cial protectionism. "We just can't for everything from the governm any more," says Béatrice Fages, a P based corporate communications s cialist. The Italian left suffered a d sive defeat when only 23% of vo turned out for a mid-June referen

ON STRIKE: *IG Metall's push for a 35-hour week backfired disastrously*

ns take advantage of the moment?

increasing job protections for work- at small companies. Even the center- Democratic Left advised people to y home, worried about the referen- n's lack of popularity. The proposal's in backer, the CGIL union federation, ly's largest labor group, was isolated. Now what? A lot still has to happen. röder's Agenda 2010 cuts unemploy- nt benefits, but it falls far short of mantling the system that makes lay- s costly and time-consuming. To fix economy, Schröder needs to shift a couple of gears. "What's currently being talked about isn't adequate," says Diether Klingelnberg, president of the German Engineering Federation. Business people are becoming more optimistic that Schröder will do more to dismantle obstacles to hiring and firing. "The government has understood the message," says Klingelnberg. Meanwhile, more moderate labor leaders are increasingly open to change. "We can't present ourselves as unable or unwilling to reform," says Hubertus Schmoldt, president of the chemical workers union.

France also has to do more. Prime Minister Jean-Pierre Raffarin got off to a promising start with pension reform. And the recent pickup in equity markets will make it easier for him to proceed with long-planned privatizations of companies such as Air France and auto maker Renault that are still partly controlled by the state. But Raffarin still has a long list of reforms to tackle, starting with the national health insurance system that is expected to run a $9 billion deficit this year. He has promised to offer details by the end of this year, probably requiring beneficiaries to pay more for their care. Such measures will be a tough sell for Raffarin, whose popularity ratings have fallen below 50%. And French President Jacques Chirac is under pressure to suspend a promised program of tax cuts.

Reforms won't go forward unless the political opposition plays along. In Germany, conservatives control the upper house of Parliament and can veto many of the reforms. Angela Merkel, chairman of the center-right Christian Democratic Union, met face-to-face with Schröder on June 25, a rare event that raised hopes of cooperation. But the CDU is divided, and other influential leaders such as Edmund Stoiber, Prime Minister of Bavaria, have spoken out against reforms that hit conservative voters, such as moves to curb subsidies for commuters and new homes.

Sobering stuff. But just a few weeks ago, few would have predicted that IG Metall would give in or that a French Prime Minister would stare down the unions. The far left is weaker than it has been in decades. Politicians across the spectrum realize they must launch reforms to save their jobs—always the best incentive. The mood favors change—change that could yet set the stage for growth.

By Jack Ewing in Frankfurt and Carol Matlack in Paris, with John Rossant in Paris

TURNING POINTS

Momentum for reform is growing in Europe

MAR. 14	MAR. 15	JUNE 15-16	JUNE 28	JUNE 29
Chancellor Gerhard Schröder breaks Social Democrat taboo by proposing cuts in job protections, pensions, and unemployment benefits.	French Prime Minister Jean-Pierre Raffarin persuades France's biggest union to support his pension reform plan. Strikes by other unions fizzle.	A national referendum in Italy to increase job protection measures for workers at small companies fails, a clear defeat for the left wing.	IG Metall, one of Germany's largest unions, admits failure to impose 35-hour workweek on companies in the East. Organized labor badly weakened.	Schröder's Cabinet proposes slashing government subsidies to pay for accelerated income tax cuts valued at more than $18 billion.

JAPAN

WILL THE RX-8 PUT MAZDA BACK IN THE RACE?

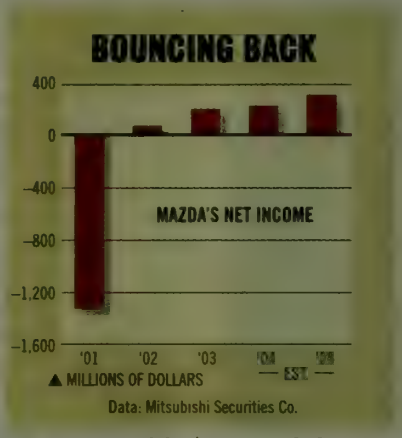
The rotary-engine coupe may rev up the sputtering carmaker

Masao Harada is a busy man these days. As Mazda Motor Corp. plans to boost production at its cavernous Hiroshima plant—where he's a top manager—he has his hands full gearing up for the change. But he's not complaining. "It's good to be busy," Harada says. He knows how it feels to be idle: A 19-year Mazda veteran, Harada lived through the company's near-death experience, a calamity that triggered Mazda's takeover in 1996 by Ford Motor Co., which now owns a controlling 33% stake.

The reason the Hiroshima factory is rocking, though, has little to do with Mazda's taskmasters in Detroit. Instead, it's the RX-8, a supercool, four-seat sports coupe with a compact rotary engine. The new car harks back to the 1980s, when Mazda turned out the Miata two-seat convertible and the RX-7, a rotary-powered hot rod. The RX-8 is Mazda's bid to get the sizzle back. "It will be a brand icon and a profitable part of our business," says Mazda President Lewis W. Booth, a former chief of Ford's Asian operations who took over Mazda a year ago.

It's too early to say whether the $25,700 RX-8 is a breakthrough car, but it's a gutsy try. Since its January launch in Japan, demand has been so strong that there's a two-month order backlog. In June, automotive writers gave the coupe's rotary the 2003 International Engine of the Year Award—an honor akin to an Oscar for piston-heads.

In early July, the RX-8 will arrive in the crucial North American market. Fortunately, the car might just be cool enough to make a splash. Despite its low-slung design, it can seat four adults—largely because of its revamped engine. The power plant is 30% lighter and 20% smaller than the one that drove the RX-7. But at 247 hp, it has just as much oomph. With intake and exhaust ports reconfigured to boost combustion efficiency, it uses 20% less fuel than the gas-guzzling RX-7 and pollutes less. "We aimed to redefine the meaning of a sports car," says Noboru Katabuchi, manager of the RX-8 program.



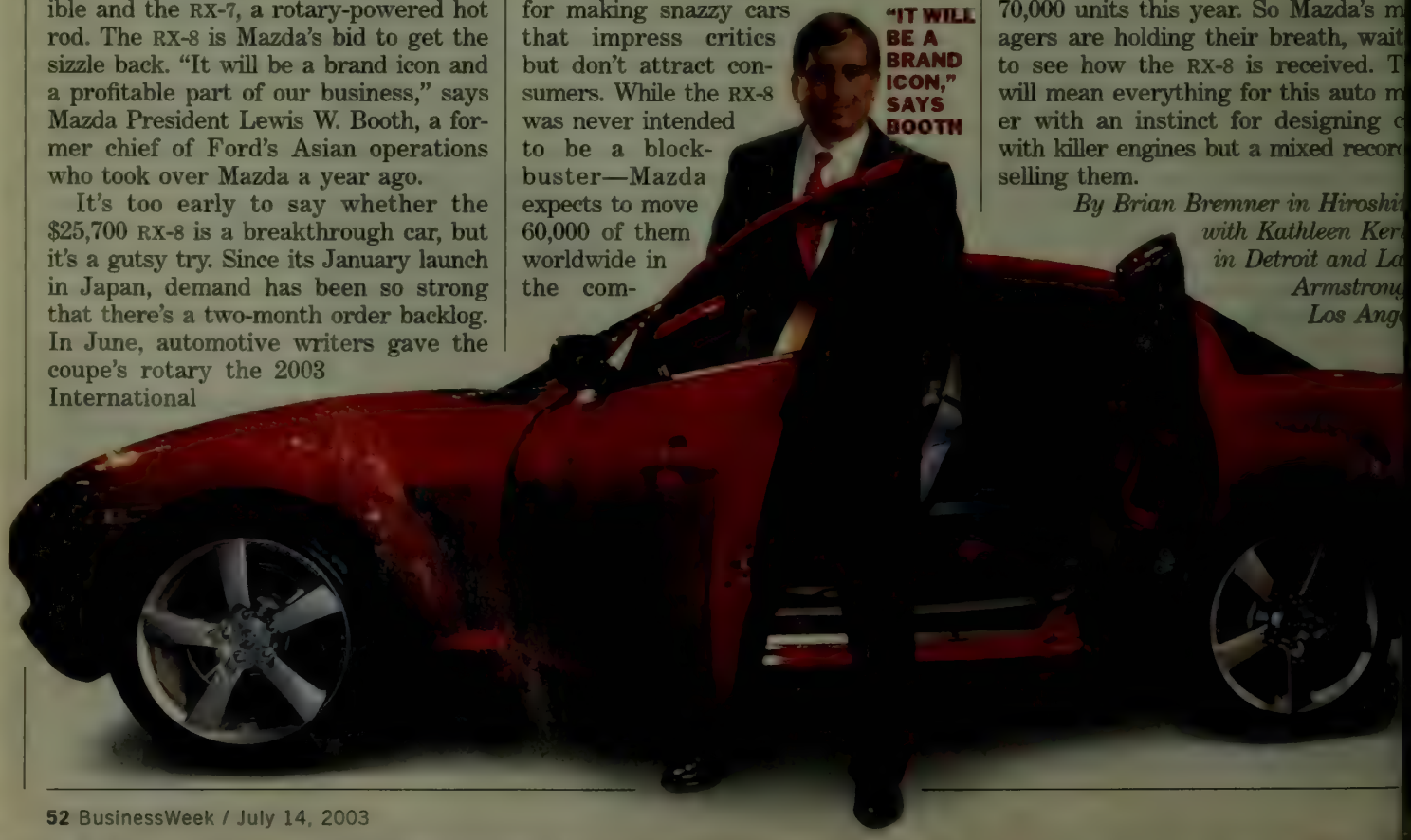
With luck, the RX-8 may also help redefine the industry's perception of Mazda. Lately, the company has been known for making snazzy cars that impress critics but don't attract consumers. While the RX-8 was never intended to be a blockbuster—Mazda expects to move 60,000 of them worldwide in the coming 12 months—Booth is hoping the car will woo customers back into showrooms. In recent years, car-buyers let Mazda "drop off their shopping list," admits Booth.

That's an understatement. Back in 1991, Mazda was Japan's No.3 carmaker and controlled 2.9% of the U.S. market. But the company soon lost its way, sliding to No.5 in Japan and letting its U.S. share drop to 1.4%. Since posting a $1.3 billion loss in fiscal 2001, Mazda has returned to profitability—which has helped boost its shares by 30% this year.

If Ford plays its cards right, Mazda might also help the U.S. giant fix its own deep problems. Mazda is expected to provide Ford with cutting-edge engine designs and to share platforms—groups of vehicles that use many common parts. Ford says the platform for the Mazda6—a sporty midsize sedan introduced last year—will become the foundation for as many as 10 cars, including the Futura sedan, a key element in the plan to replace the Taurus.

Still, Mazda has a long way to go to get back to its glory days of the 1980s. For starters, it still hasn't quite figured out its marketing. In Japan and Europe the $20,000 Mazda6 has exceeded sales estimates. But in the U.S., it has yet to catch on. A December launch failed to attract attention. Then more customers than expected wanted the Mazda6 with the V-6 engine, and Mazda had to scramble to fill demand. The Mazda6 will almost certainly miss its sales target of 70,000 units this year. So Mazda's managers are holding their breath, waiting to see how the RX-8 is received. That will mean everything for this auto maker with an instinct for designing cars with killer engines but a mixed record of selling them.

By Brian Bremner in Hiroshima with Kathleen Kerr in Detroit and Lee Armstrong Jr. in Los Angeles



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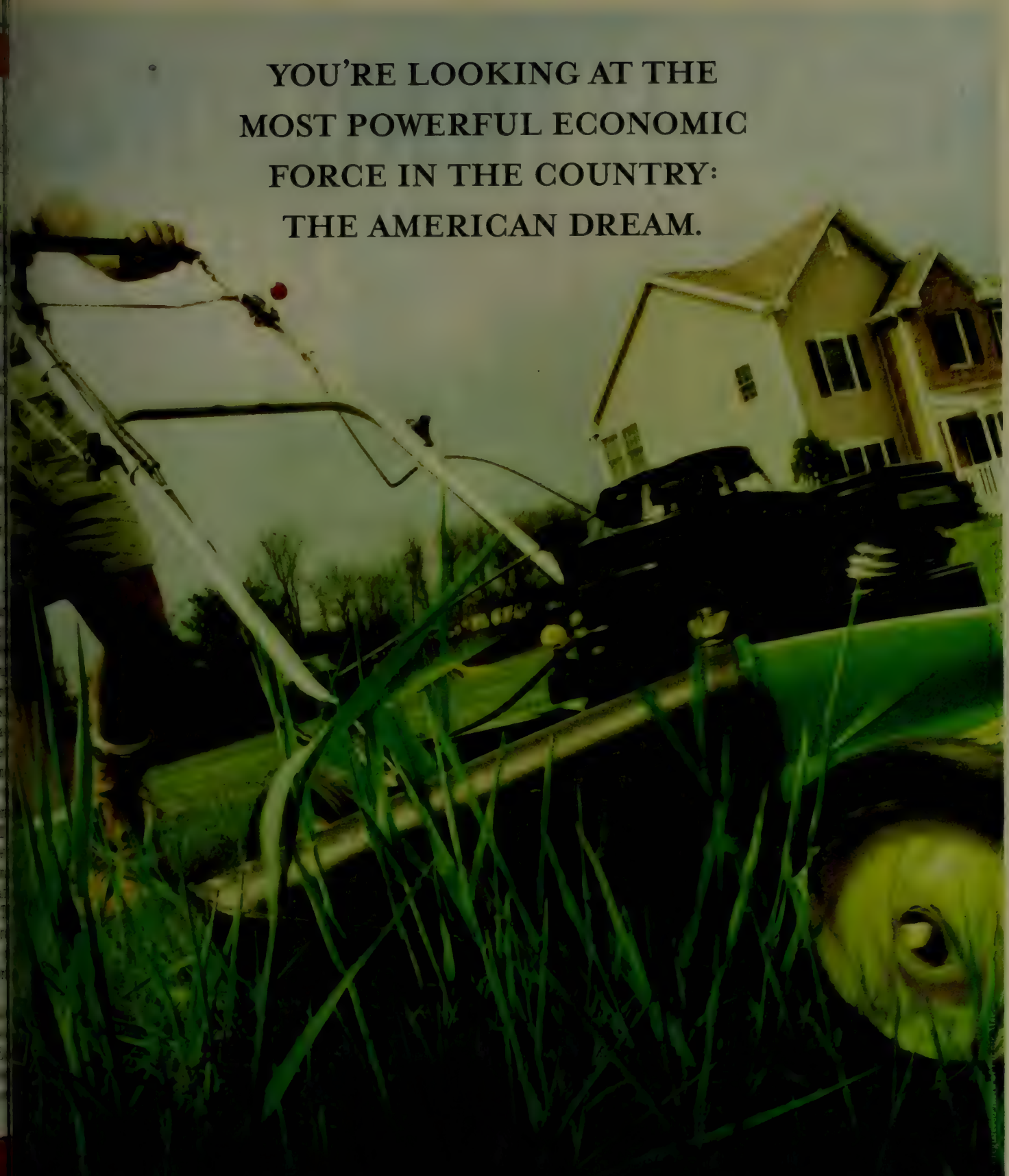

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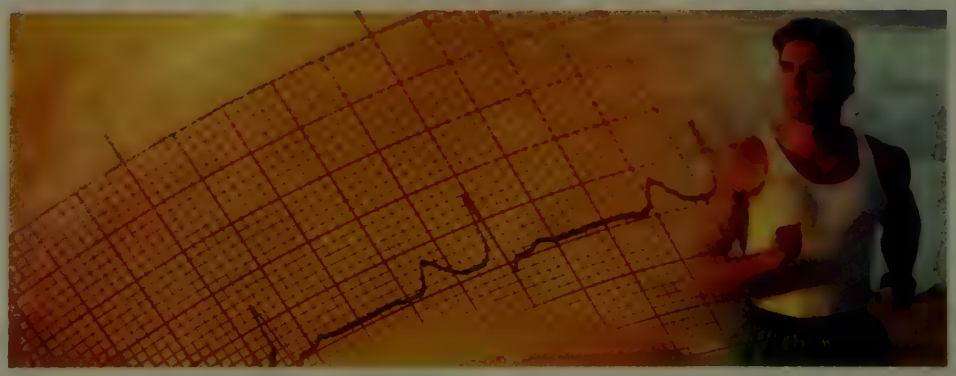
HEALTH HORIZONS



Healthy Hearts: Tips from the American Heart Association

Robert O. Bonow, MD

The heart is one of the body's most resilient organs, yet heart disease continues to take an excessive toll. In fact, cardiovascular diseases remain the leading cause of death for both men and women. Fortunately, the evidence is clear that these conditions often can be prevented - but you have to do your part.

The first step to keeping your heart healthy is to determine your risk factor profile with the help of your doctor. Doctors now know that multiple slight risks may be more dangerous than a single obviously elevated one, and the information about many risk factors can be combined to determine your chances of developing heart disease over the next 10 years. To do this your doctor will measure your blood pressure and assess your body weight in relation to your height at least every two years, and test your cholesterol and glucose levels at least every five years.

Of course you can't do anything about some risk factors (being male, growing older or having a family history of heart problems), but you can take control of many others. Here are some proven steps to keep your heart healthy:

■ **Say a firm farewell to smoking.** Smoking is among the most hazardous activities for your health, and smoking cessation can reduce your risk of heart disease substantially. Sure it's hard, but your doctor will help you develop a plan for quitting and, if necessary, can prescribe medications that can make it easier.

■ **Lower the pressure.** High blood pressure puts a strain on your heart and arteries. You can reduce it with a few simple lifestyle changes: Keep your weight under control; use herbs instead of salt to flavor your food; eat more fruits, vegetables and low-fat dairy products; make sure you get enough regular physical activity; and limit alcohol to no more than two drinks a day if you're a man, one if you're a woman. If these steps don't work, your doctor may prescribe medications to keep your blood pressure at a healthy level.

■ **Eat in good health.** Go easy on saturated fats (the kind present in butter and meat) and trans fats (found in hard margarine, commercial baked goods and some fried fast food); substitute whole grains for white flour; and acquaint yourself with the pleasures of fresh fruits and vegetables. If you substitute canola or olive oil for butter or margarine when you cook, you'll do your heart a favor. The fats found in fish are particularly healthful for the heart and blood vessels.

■ **Talk to your doctor about aspirin.** Some people should take it, some shouldn't. Your doctor can advise you about aspirin's benefits and disadvantages in your particular case.

■ **Keep your cholesterol in check.** A wealth of studies leaves no doubt that using statin drugs to lower high levels of LDL cholesterol reduces the risk of heart disease and stroke by as much as 25 to 40 percent. These drugs may be needed if your cholesterol remains elevated despite a healthy diet and regular exercise.

■ **Head out the door.** Brisk walks are good, more energetic exercise is better, and a combination of vigorous activity, resistance training and flexibility exercises is best. Not only will your heart benefit, but you'll drop unwanted pounds. Think of the pleasure of once again fitting into those pants hanging at the back of your closet for the last five years.

■ **Heart Profiler to the rescue!** If you already have a heart problem such as atrial fibrillation, high cholesterol, coronary artery disease, heart failure, or high blood pressure, the American Heart Association's free, confidential online service can help you understand more about it. A Heart Profiler report, tailored specifically for you, will tell you about treatment options, potential side effects, success rates and relevant research studies. Your personal record won't be shared with anyone else. To learn more, log on to www.americanheart.org/heartprofilers.

Robert O. Bonow, M.D. is the immediate-past president of the American Heart Association and chief of the Division of Cardiology at the Northwestern University Feinberg School of Medicine in Chicago.

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*Be sure to discuss all of your risk factors with your doctor.

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APAN'S MILITARY MUSCLE S TIPPING ASIA'S BALANCE OF POWER

Japanese missile-defense system, spy satellites, and self-defense forces dispatched to global hot spots? Two years ago, any Japanese Prime Minister who backed such ns wouldn't have had his job for long. Howls of protest at me would have been surpassed only by shouts of indigna- n from Seoul and Beijing. For decades, the central maxims Japanese foreign policy seemed to boil down to: Write a lot checks and don't rock the diplomatic boat.

But sometime in the future, generals, politicians, and poli- makers on both sides of the Pacific may look back on this ar and conclude that it was the moment when Japan's stwar pacifism faded away. A rare con- ence of events, motives, and personali- s is pushing Japan to assert itself mili- ily on a scale few would have imagined. The key mover in this drama is Prime nister Junichiro Koizumi, who is deftly pping into the Japanese yearning for a re robust defense, a desire triggered by e September 11 attacks on the U.S. d the rising threat from North Korea. early June, the Diet passed legislation tlining how Japan would respond to an ack. On June 25, Koizumi kicked off a ecial Diet session to consider legislation elling out what role Japanese troops ll play in Iraq. If all goes well for Koizumi—as is expect- —some 1,000 heavily equipped Japanese self-defense ces could be in Iraq by yearend.

Also in June, the government approved a plan to produce th the Pentagon a Patriot Advanced Capability (PAC-3) rface-to-air guided missile air-defense system. That could d to a sea-based missile system designed to deter an attack m North Korea, says Masashi Nishihara, an international ations professor at Japan's National Defense Academy. pan fears an assault from Pyongyang, which may be more ely to strike at Tokyo than at South Korea in any face-off with the U.S. Japan could even be readying to remove the greatest taboo of them all. The ruling Liberal Democratic Party has released a national security analysis that suggests Japan consider revising its war-renouncing Constitution, which was essentially written by U.S. occupiers.

Won't Japan's neighbors stop Koizumi from his buildup? Even here, Koizumi's luck seems to be holding. Just as Japan's citizens seem to accept this new assertiveness, Beijing and Seoul—the biggest victims of Japanese military adventures in the past—have been eerily silent. North Korea may be one reason. There's little doubt that North Korea's Nodong ballistic missiles have the range to strike Japan, not to mention all of South Korea and much of China. Right now, all three countries—and the U.S.—need to stay united if they hope to persuade Pyongyang to eliminate its nuclear-weapons program. "Everyone thinks Japan is moving too quickly and too aggressively. But the Chinese government has decided to deal more realistically with Japan," says Shi Yinhong, a professor of international relations at People's University in Beijing. That means more behind-the-scenes diplomacy rather than public outbursts about rising militarism.

RISING SUN: *Destroyers on parade*

There is no talk in Japan of deploying offensive ballistic missiles or going nuclear. Tokyo cannot afford a gargantuan U.S.-style military. But Japan seems ready to admit some obvious truths: It lives in a dangerous region, and its defense budget, $42 billion, is still one of the biggest in the world. As one U.S. State Dept. official puts it, "Japan has to react to the environment in which it finds itself." That's a world with plenty of terrorists who might happily strike a U.S. ally. If that doesn't kick in a country's survival instincts, nothing will.

By Brian Bremner in Tokyo, with Dexter Roberts in Beijing and Stan Crock in Washington

GLOBAL WRAPUP

LSTOM'S ACCOUNTING WOES

The French government is offering hand to Alstom, the Paris engineer- ng group under investigation for U.S. ccounting improprieties. AREVA, a overnment-owned nuclear-energy roup, offered on July 1 to buy Al- tom's energy-transmission-and-distri- ution unit for an undisclosed sum. Al- tom, which posted a $1.6 billion loss st year, is eager to reassure in- estors by raising cash but has had rouble finding buyers for some of its ssets. On June 30, the day before AREVA's announcement, Alstom shares fell 4.5% when the company disclosed that it was taking a $58 million charge for understated losses at its U.S. transportation subsidiary. Alstom has suspended two of the unit's executives, and the FBI and Securities & Exchange Commission are investigating.

BIG SQUEEZE IN BRAZIL

► Brazil's central bank, widely praised by financial markets for sticking to tight monetary policy in the face of powerful political opposition, may have kept interest rates too high for too long. In a report released on June 30, the bank said that if its base rate remained stable at the current 26%, inflation in 2004 would be 4.2%, well below its target of 5.5%. Since President Luiz Inácio Lula da Silva took office on Jan. 1, the economy has shown every sign of being squeezed. Industrial production fell for four months running through April, and unemployment has risen steadily, to 12.8% in May. Help is on the way. The central bank's report was taken as a clear message that interest rates will fall further, following a half-point cut on June 18.

TOP GLOBAL COMPANIES

U.S. companies still prevail, despite the dollar's fall vs. the euro

Special Report

Remember when telecoms were just about the scariest investments on the planet? France Télécom, NTT DoCoMo, Verizon, Lucent, Alcatel—every telco and telecom-equipment stock in the world just about rolled over and died in the past three years. This amazing experience was recorded faithfully in the Global 1000, the *BusinessWeek* list of the world's thousand top companies by market capitalization. (A list of the top 200 of this year's companies follows this story: The remaining 800 are listed online, at www.businessweek.com/magazine/extra.htm.)

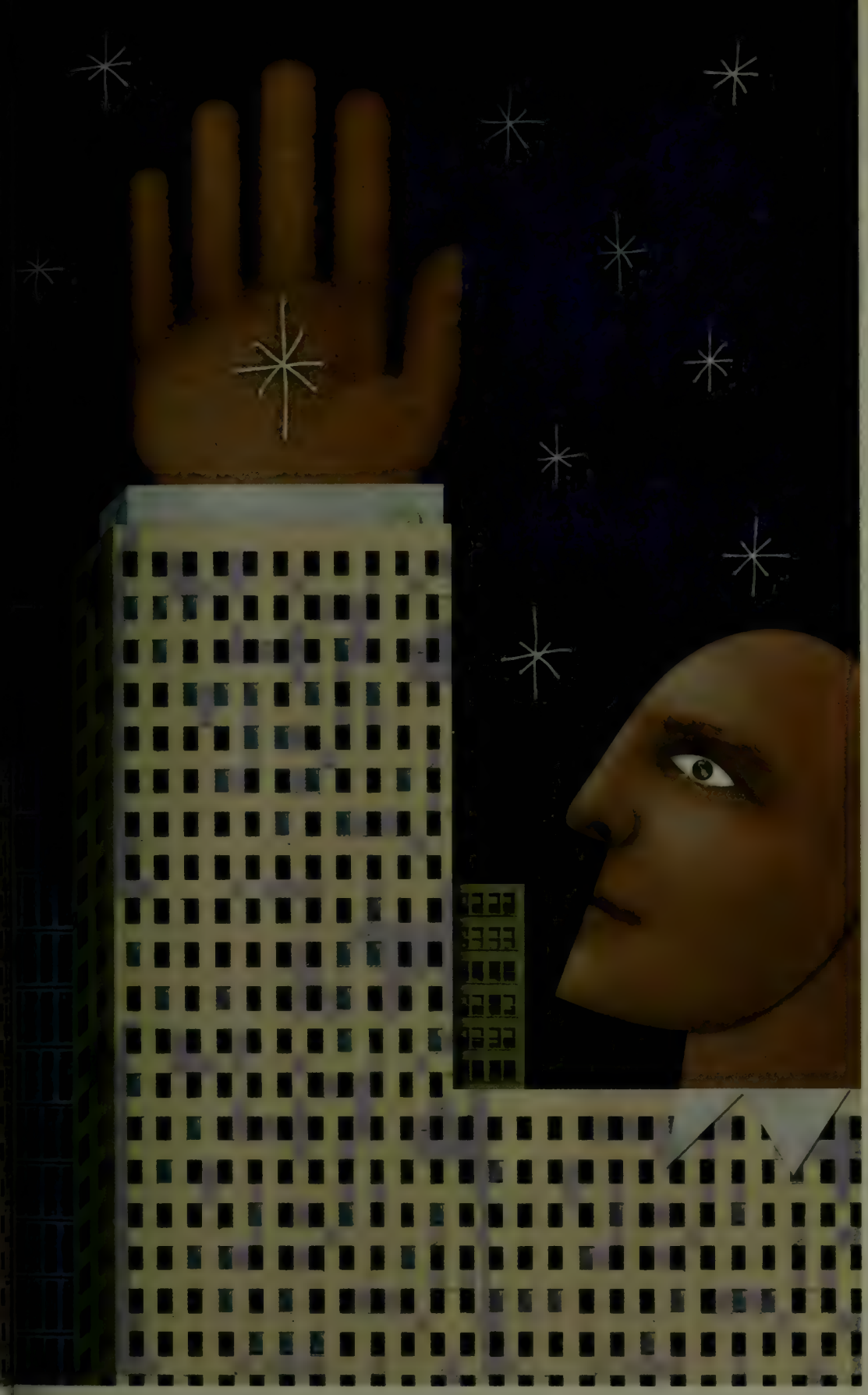
But what the market taketh away, it giveth back as well. Just ask the executives at Nextel Communications Inc. The Reston (Va.) company topped the list of high-jumpers on this year's Global 1000 survey, rising from a subterranean 988 to a much more respectable 244. Nextel is on track for another year of strong earnings growth, after posting its first-ever profit in 2002. It's cashing in on walkie-talkie-enabled mobile phones favored by workers in construction and real estate. Turns out these blue-collar clients are not only extremely loyal but also willing to pay premium prices for dependable service. Now it's catching on with the rest of us, too. Nextel boasts the highest average revenue per subscriber—at $71—and the lowest churn rate of any major wireless carrier in the U.S. "Our mantra is to be first, to be better, and to be different," says Timothy Donahue, Nextel's president and CEO.

Nextel is also benefiting from the upward lift in the whole sector. As a group, telecoms, including U.S. companies such AT&T Wireless Services Inc. and European heavyweights such as Deutsche Telekom and France Télécom, were the best performers in the past year, up 3%. Yes, the sector is still trading well below its high point of three years ago. But many of these companies have trimmed debt loads and repositioned themselves for growth.

Telecoms weren't the only winners. Other smart companies also managed to wring out gains despite a near-worldwide slump in consumer sentiment in the past 12 months. Using data from Morgan Stanley Capital International Inc. in Geneva, *BusinessWeek* ranked companies in 23 countries by market capitalization as of May 30. While total market value fell for a third straight year, down 9.6%, to $16.7 trillion, there's some evidence that—dare we say it?—the worst is over, despite war, recession, and epidemic.

That's not to say the best is at hand. Global recovery may still be soft: That's why Alan Greenspan thought another interest rate cut was in order on June 25. But the case for some sort of stabilization is mounting. One encouraging sign is that the pace of the dropoff in the Global 1000's market value slowed to single digits for the first time in two years. Indeed, Wall Street's unexpectedly resilient rally year is being echoed in markets fr Tokyo to Tel Aviv.

One thing was surprisingly unchang The greenback's slide against the e failed to give much of an edge to Eu pean multinationals on the dollar-ba market cap survey. That sounds co terintuitive: Global 1000 companies wh shares trade in euros automatically



assist by the 22% gain in the euro inst the dollar over the last year. But e downdraft in Continental economies hurt European companies much more n America's near-recession has dam-ed U.S. giants. And a weak dollar nefits U.S. exporters, which also helps ir shares. Besides, some of the Amer-n companies are so dominant that n a currency slide can't budge them. Thus American giants such as General Electric (No. 1), Microsoft (No. 2), and Exxon Mobil (No. 3) kept a lock on 8 of the top 10 slots in the survey.

True, GE's stock price under Chairman and CEO Jeffrey Immelt is about half of what it hit three years ago during the final golden stretch under former Chairman Jack Welch. But GE has proved a wily survivor. And its shares are up by about 30% since February. Despite troubles at its plastics division, Chief Financial Officer Keith Sherin expects net income to rise between 3% and 13% this year, thanks to gains in other areas, including strong ad sales at NBC and some big orders for aircraft engines. "We're positioned for an economic rebound, [but] we're not counting on it," he told analysts at a June 20 meeting.

The vitality of the American companies on the list shows up in other ways. One is in mergers and acquisitions: The strongest U.S. companies are among the few on earth rich enough to do big deals. Thus, household-product kingpin Procter & Gamble Co., which has a big profit rebound going, launched a takeover of Wella in March, offering a 20% premium over the pre-bid stock price. Although the German hair-care giant's management has yet to formally accept the bid, the surge in Wella's share price sent its market value soaring, making it the list's seventh-biggest gainer.

Also in the M&A file: New York drugmaker Pfizer's merger with Pharmacia. That deal, concluded on April 16, pushed up the combined company's revenue to $45 billion and made it the No. 4 company overall on the Global 1000. It's also among the ten most profitable companies on the list: Citigroup and GE head that ranking.

America's strength showed in tech, too, where the IT blue chips advanced even as overall corporate spending on tech upgrades grew at a diminished pace. Analysts say perennial winner Microsoft Corp. saw its server software business grow about 16% in the past year. Meanwhile, the Windows and Office PC software monopolies together generated nearly $20 billion in sales in the year ended June 30. The profitability of the two products is helping Microsoft to add about $1 billion a month to its cash position.

Nothing in telecom holds a candle to Microsoft, but at least this critical in-

dustry is showing signs of a rebound. The problems seemed epic only a few months ago. But in Europe, things have finally stabilized after a cleansing period of credit downgrades, bankruptcies, and CEO firings at BT Group, KPN, Deutsche Telekom, and France Télécom. Deutsche Telekom is looking more attractive because it has cut debt and also reported a profit in the first quarter after a $29 billion loss in 2002. "Cost-cutting alone won't create new perspectives," CEO Kai-Uwe Ricke told shareholders recently. But the company's most painful period may be behind it.

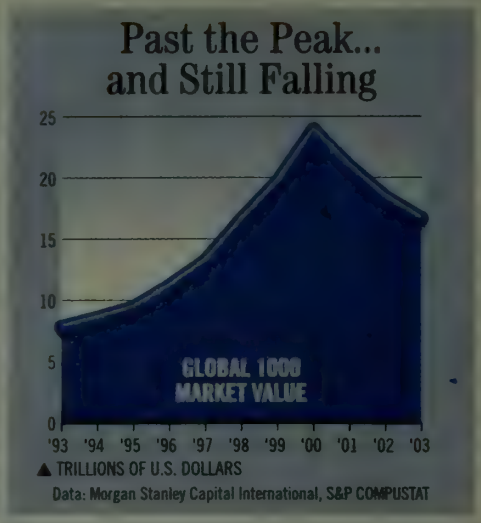
The same can be said of Deutsche Telekom's rivals. During the worst of the crisis, these companies were deeply undervalued; France Télécom was priced at a fraction of its assets and less than the value of its stock in its wireless division, Orange. Now, investors figure the remaining telco giants are in no danger of ever going bust, and they recognize these companies spin off billions of dollars a year in free cash flow.

Further afield, the telecom business of Yahoo! Japan gave it a big boost on the Global 1000 rating, as it leaped from No. 797 to No. 342, making it one of the top three gainers this year.

Special Report

That's no surprise to investors in its stock, which has performed spectacularly. The price stems not only from its mainstay online-auction service, with 11 million subscribers, but also from Yahoo BB, a popular broadband service in Japan.

Another strong Japanese telecom play is NTT DoCoMo, one of the top 25 companies on this year's Global 1000 and the highest-ranked from Japan. After falling into the red last year, DoCoMo made $1.8 billion in net profit on sales of



$40.8 billion for the year ended in March. Restructuring, new and faster phones, and a slow-but-steady expansion of its i-mode Internet mobile phones globally are having an effect. "With better phones and wider coverage, users are beginning to migrate to 3G," says Kiyoyuki Tsujimura, a company senior vice-president.

The telcos are reviving because of their strong cash flow. That's a strategy employed by winners in other industries as well. Britain's buttoned-down HSBC Holdings PLC is the world's No. 2 bank. Its recent acquisitions include Republic National Bank of New York, Safra National Bank, Mexico's GFBital, and, most recently, Household Financial. "In the past 12 months, we have taken advantage of some important new opportunities to grow," says Stephen Green, HSBC CEO. The deal spree pushed HSBC up eight notches on the list, to No. 14. A conservative financial position, cautious management, and a strong balance sheet helped HSBC during the long bear market.

HSBC has generated much of its profits in Hong Kong. But after its recent string of acquisitions, business in the U.S. accounts for about 30% of its assets and estimated 2003 pre-tax pro
Now, the bank is turning its attenti
to newer markets such as mainla
China and, yes, even Iraq. Along w
rival Citigroup, HSBC hopes for a role
the reconstruction of the Iraqi banki
system.

Britain harbors financial highfliers t
Most notable: the Man Group PLC, wh
zoomed from No. 989 to No. 618 on t
list. Man has come a long way from
roots as a sugar broker, set up in 17
Almost 200 years later, the compa
parlayed its prowess as a sugar dea
into businesses trading in other ag
cultural commodities. Now, it's t
world's largest publicly traded hed
fund. Man has benefited from the dov
turn in global equity markets as wealt
investors turn to riskier hedge funds
search for yields.

In contrast to Man and HSBC, Jap
produced big losers in finance. T
Japanese banks rank among the wo
five performers: UFJ Holding and Mizu
Financial. Sumitomo Mitsui and Sur
tomo Trust were also big disappoi
ments. Despite their colossal asse
Japanese banks suffer from mounti
bad debts, shaky capital bases, a
shrinking reserves. Thus investors
Mizuho, Japan's largest bank and
product of a mega-merger, have l
90% of their money since Mizuho sta
ed trading back in late 2000. Hard
believe, but just a decade ago, Japan
banks took 4 of the top 10 slots in t
Global 1000—scary proof of how quic
fortunes change in the markets.

*By Chester Dawson in New Yo
with Diane Brady in New York, J
Greene in Seattle, Kerry Capell in L
don, and bureau reports*

BusinessWeek online

For the entire Global 1000 list and related stories, go to www.businessweek.com/magazine/extra.htm

Who's Who in the Global 1000

MARKET VALUE BILLIONS OF U.S. DOLLARS		SALES BILLIONS OF U.S. DOLLARS		PROFITS BILLIONS OF U.S. DOLLARS		SHARE-PRICE GAIN % CHANGE FROM 2002 IN U.S. DOLLARS	
1 GENERAL ELECTRIC	$286.10	1 WAL-MART STORES	$244.52	1 CITIGROUP	$15.32	1 NEXTEL COMMUNICATIONS	208%
2 MICROSOFT	263.99	2 EXXON MOBIL	204.51	2 GENERAL ELECTRIC	15.13	2 YAHOO! JAPAN	117
3 EXXON MOBIL	244.93	3 GENERAL MOTORS	184.21	3 ALTRIA GROUP	11.10	3 TELE2	105
4 PFIZER	244.89	4 ROYAL DUTCH/SHELL	179.43	4 EXXON MOBIL	11.01	4 EXPEDIA	105
5 WAL-MART STORES	232.22	5 BP	178.72	5 ROYAL DUTCH/SHELL	9.42	5 CITRIX SYSTEMS	105
6 CITIGROUP	210.86	6 FORD MOTOR	162.59	6 BANK OF AMERICA	9.25	6 GARMIN	101
7 JOHNSON & JOHNSON	161.36	7 DAIMLERCHRYSLER	156.84	7 PFIZER	9.18	7 AMAZON.COM	97
8 ROYAL DUTCH/SHELL GROUP	158.48	8 TOYOTA MOTOR	134.23	8 WAL-MART STORES	8.04	8 HOTELS.COM	90
9 BP	153.24	9 GENERAL ELECTRIC	131.70	9 TOYOTA MOTOR	7.90	9 COACH	88
10 AIG	150.97	10 ALLIANZ	126.80	10 MICROSOFT	7.83	10 BOSTON SCIENTIFIC	87

Data: Morgan Stanley Capital International, S&P COMPUSTAT

The World's Top 200 Companies

RKET VALUE: Share price on May 30, 2003, multiplied by latest available number of shares outstanding, translated into U.S. dollars at month-end exchange rates. Market value may include several classes of stock; prices based on the company's most widely held issue.

for individual companies: Morgan Stanley Capital International Inc., unless otherwise indicated. For further information on MSCI data, contact Morgan Stanley at 212-762-3473 York) or 44 207 425 6660 (London) or 41 22 817 9000 (Geneva). Rankings calculated by *BusinessWeek*. Additional data provided by Standard & Poor's COMPUSTAT, if footnoted.

RANK 03	2002		MARKET VALUE Billions of U.S. dollars	
1	1	GENERAL ELECTRIC	U.S.	286.10
2	2	MICROSOFT	U.S.	263.99
3	3	EXXON MOBIL	U.S.	244.93
4	6	PFIZER (8)	U.S.	244.89
5	4	WAL-MART STORES	U.S.	232.22
6	5	CITIGROUP	U.S.	210.86
7	9	JOHNSON & JOHNSON (8)	U.S.	161.36
8	7	ROYAL DUTCH/SHELL GROUP (1)	Neth./Britain	158.48
9	8	BP	Britain	153.24
10	11	AMERICAN INTERNATIONAL GROUP (8)	U.S.	150.97
11	13	INTERNATIONAL BUSINESS MACHINES	U.S.	148.80
12	27	VODAFONE GROUP	Britain	147.99
13	10	INTEL (8)	U.S.	136.04
14	22	HSBC HOLDINGS	Britain	126.97
15	15	MERCK	U.S.	124.81
16	16	GLAXOSMITHKLINE	Britain	118.96
17	21	PROCTER & GAMBLE (8)	U.S.	118.88
18	23	CISCO SYSTEMS (8)	U.S.	115.17
19	17	NOVARTIS	Switzerland	113.09
20	12	COCA-COLA	U.S.	112.97
21	19	BANK OF AMERICA	U.S.	111.06
22	25	BERKSHIRE HATHAWAY	U.S.	108.98
23	14	NTT DOCOMO	Japan	105.31
24	26	TOTAL	France	103.78
25	20	VERIZON COMMUNICATIONS	U.S.	103.55
26	28	TOYOTA MOTOR	Japan	86.32
27	48	NOKIA	Finland	86.09
28	18	ALTRIA GROUP	U.S.	85.43
29	24	SBC COMMUNICATIONS	U.S.	84.53
30	70	AMGEN	U.S.	83.29
31	30	NESTLE	Switzerland	83.00
32	33	WELLS FARGO	U.S.	81.72
33	46	DELL COMPUTER	U.S.	80.70
34	34	VIACOM	U.S.	80.18
35	32	PEPSICO	U.S.	76.34
36	31	CHEVRONTEXACO (8)	U.S.	75.79
37	29	HOME DEPOT	U.S.	75.56
38	35	ROYAL BANK OF SCOTLAND GROUP	Britain	75.13
39	37	FANNIE MAE	U.S.	73.19
40	43	ROCHE HOLDING	Switzerland	72.61
41	49	UNITED PARCEL SERVICE (8)	U.S.	69.92
42	38	ASTRAZENECA	Britain	69.67
43	40	ABBOTT LABORATORIES	U.S.	69.61
44	36	AOL TIME WARNER (8)	U.S.	68.36
45	88	ORACLE (8)	U.S.	68.20
46	47	UBS	Switzerland	67.63
47	169	COMCAST (8)	U.S.	67.21
48	44	ELI LILLY (8)	U.S.	67.15
49	45	J.P. MORGAN CHASE (8)	U.S.	66.71
50	52	ENI	Italy	64.58
51	77	DEUTSCHE TELEKOM	Germany	62.85
52	64	TELECOM ITALIA	Italy	60.12
53	55	HEWLETT-PACKARD (8)	U.S.	59.51
54	59	MEDTRONIC	U.S.	59.46
55	50	UNILEVER (2)	Neth./Britain	59.36
56	42	WYETH (8)	U.S.	58.19
57	184	FRANCE TELECOM	France	57.45
58	67	TELEFONICA	Spain	56.80
59	39	KRAFT FOODS (8)	U.S.	56.10
60	41	NIPPON TELEGRAPH & TELEPHONE	Japan	55.58
61	57	AMERICAN EXPRESS	U.S.	54.75
62	66	WACHOVIA (8)	U.S.	54.04
63	68	MORGAN STANLEY	U.S.	49.67
64	53	BRISTOL-MYERS SQUIBB (8)	U.S.	49.62
65	73	3M (8)	U.S.	49.43
66	51	BELLSOUTH	U.S.	49.27
67	74	L'OREAL	France	49.06
68	85	SANOFI-SYNTHELABO	France	46.81
69	56	BARCLAYS	Britain	46.19
70	161	ORANGE	France	45.58
71	81	U.S. BANCORP (8)	U.S.	45.48
72	80	ANHEUSER-BUSCH	U.S.	45.05
73	109	TIM	Italy	44.76
74	69	BNP PARIBAS	France	44.33
75	82	HBOS	Britain	44.11
76	75	BANC ONE	U.S.	43.51
77	110	ENEL	Italy	42.22
78	61	SIEMENS	Germany	42.20
79	78	DUPONT	U.S.	41.87
80	60	AVENTIS	France	41.65

Global ranking calculated for Royal Dutch/Shell Group by combining market value of the Netherlands' Royal Dutch Petroleum and Britain's Shell Transport & Trading. 2) Global king calculated for Unilever by combining market value of the Netherlands' Unilever NV and Britain's Unilever PLC. 3) Global ranking calculated for BHP Billiton by combin- market value of Britain's BHP Billiton LTD. and Australia's BHP Billiton LTD. 4) Global ranking calculated for Rio Tinto by combining market value of Britain's Rio Tinto and Australia's Rio Tinto LTD. 5) Global ranking calculated for Carnival by combining market value of Britain's Carnival PLC and Carnival Corp. of the U.S. 6) Global ranking culated for Reed Elsevier by combining market value of Britain's Reed Elsevier and the Netherlands' Reed Elsevier. 7) Global ranking calculated for Brambles Industries by mbining market value of Britain's Brambles Industries PLC and the Australia's Brambles Industries LTD. 8) Data for this company provided by Standard & Poor's COMPUSTAT. =Not ranked.

2003 Leaders

RANK 2003	RANK 2002		MARKET VALUE Billions of U.S. dollars	
81	79	FREDDIE MAC	U.S.	41.48
82	54	LLOYDS TSB GROUP	Britain	40.93
83	117	MERRILL LYNCH (8)	U.S.	40.28
84	76	WALT DISNEY (8)	U.S.	39.56
85	106	GOLDMAN SACHS GROUP	U.S.	38.91
86	87	BANCO SANTANDER CENTRAL HISPANO	Spain	38.59
87	101	WASHINGTON MUTUAL	U.S.	38.56
88	119	TELSTRA	Australia	37.81
89	124	CANON	Japan	36.67
90	NR	CONOCOPHILLIPS	U.S.	36.52
91	83	DEUTSCHE BANK	Germany	36.41
92	120	NEWS CORP.	Australia	36.27
93	111	E.ON	Germany	35.64
94	130	NISSAN MOTOR	Japan	35.61
95	102	GILLETTE	U.S.	35.46
96	71	TEXAS INSTRUMENTS (8)	U.S.	35.45
97	160	TELEFONICA MOVILES	Spain	35.45
98	126	SAP	Germany	35.35
99	89	TYCO INTERNATIONAL (8)	U.S.	35.34
100	92	HONDA MOTOR	Japan	35.11
101	95	TAKEDA CHEMICAL INDUSTRIES	Japan	34.87
102	91	DIAGEO	Britain	33.93
103	112	BHP BILLITON (3)	Australia/Brit.	33.65
104	103	TARGET	U.S.	33.29
105	100	FIFTH THIRD BANCORP	U.S.	33.22
106	135	NATIONAL AUSTRALIA BANK	Australia	33.00
107	105	LOWE'S	U.S.	33.00
108	65	ING GROEP	Netherlands	32.41
109	127	UNITED TECHNOLOGIES	U.S.	32.33
110	86	CREDIT SUISSE GROUP	Switzerland	32.31
111	270	EBAY (8)	U.S.	32.10
112	147	COLGATE-PALMOLIVE	U.S.	32.09
113	113	CARREFOUR	France	32.07
114	223	GENENTECH (8)	U.S.	31.94
115	72	DAIMLERCHRYSLER	Germany	31.86
116	98	BANCO BILBAO VIZCAYA ARGENTARIA	Spain	31.57
117	96	WALGREEN	U.S.	31.56
118	104	FLEETBOSTON FINANCIAL	U.S.	31.04
119	142	FIRST DATA (8)	U.S.	30.98
120	144	ABN AMRO HOLDING	Netherlands	30.78
121	138	LIBERTY MEDIA	U.S.	30.67
122	146	ASSICURAZIONI GENERALI	Italy	30.37
123	62	ALLIANZ	Germany	29.61
124	156	UNITEDHEALTH GROUP	U.S.	29.21
125	141	DOW CHEMICAL (8)	U.S.	29.11
126	182	UNICREDITO ITALIANO	Italy	28.80
127	168	ROYAL BANK OF CANADA	Canada	28.55
128	145	SCHLUMBERGER (8)	U.S.	28.31
129	190	CREDIT AGRICOLE	France	27.86
130	116	BT GROUP	Britain	27.35
131	154	TOKYO ELECTRIC POWER	Japan	27.32
132	162	RIO TINTO (4)	Australia/Brit.	27.18
133	97	SCHERING-PLOUGH	U.S.	27.06
134	158	MARSH & McLENNAN	U.S.	26.92
135	125	KIMBERLY-CLARK	U.S.	26.71
136	175	QUALCOMM (8)	U.S.	26.51
137	123	AXA	France	26.40
138	152	SOCIETE GENERALE	France	26.39
139	143	CARDINAL HEALTH	U.S.	26.25
140	115	HUTCHISON WHAMPOA	Hong Kong	25.91

RANK 2003	RANK 2002		MARKET VALU Billions of U.S. dolla	
141	94	ROYAL PHILIPS ELECTRONICS	Netherlands	25.7
142	107	APPLIED MATERIALS	U.S.	25.6
143	139	MBNA	U.S.	25.6
144	159	ALLSTATE (8)	U.S.	25.3
145	195	FOX ENTERTAINMENT GROUP	U.S.	25.3
146	155	BASF	Germany	25.2
147	167	LVMH MOET HENNESSY LOUIS VUITTON	France	25.1
148	134	CLEAR CHANNEL COMMUNICATIONS	U.S.	24.9
149	63	SONY	Japan	24.5
150	122	BOEING	U.S.	24.5
151	164	TESCO	Britain	24.1
152	NR	CARNIVAL (5)	U.S./Britain	23.9
153	99	McDONALD'S	U.S.	23.7
154	260	EMC (8)	U.S.	23.6
155	166	BRITISH AMERICAN TOBACCO	Britain	23.4
156	84	MITSUBISHI TOKYO FINANCIAL GROUP	Japan	23.1
157	178	COMMONWEALTH BANK OF AUSTRALIA	Australia	23.0
158	153	BMW	Germany	22.7
159	131	HONEYWELL INTERNATIONAL (8)	U.S.	22.4
160	216	SOUTHERN CO.	U.S.	22.4
161	151	MATSUSHITA ELECTRIC INDUSTRIAL	Japan	22.2
162	163	BANK OF NEW YORK	U.S.	22.1
163	176	EMERSON ELECTRIC	U.S.	22.0
164	228	BANK OF NOVA SCOTIA	Canada	21.4
165	149	FORTIS	Belgium	21.3
166	398	BOSTON SCIENTIFIC	U.S.	21.2
167	157	LOCKHEED MARTIN	U.S.	21.1
168	205	GANNETT	U.S.	21.1
169	192	AT&T WIRELESS SERVICES (8)	U.S.	21.0
170	201	BRITISH SKY BROADCASTING GROUP	Britain	21.0
171	215	Banca Intesa	Italy	20.9
172	129	AUTOMATIC DATA PROCESSING (8)	U.S.	20.8
173	148	ALCOA	U.S.	20.7
174	137	SWISS RE	Switzerland	20.7
175	203	NATIONAL CITY	U.S.	20.6
176	114	SEVEN-ELEVEN JAPAN	Japan	20.5
177	174	STMICROELECTRONICS	France	20.3
178	196	HANG SENG BANK	Hong Kong	20.3
179	227	SYSCO	U.S.	20.3
180	281	BCE (BELL CANADA ENTERPRISES)	Canada	20.0
181	333	NATIONAL GRID TRANSCO	Britain	20.0
182	136	NOMURA HOLDINGS	Japan	19.9
183	218	SWISSCOM	Switzerland	19.9
184	118	GENERAL MOTORS (8)	U.S.	19.8
185	108	MOTOROLA (8)	U.S.	19.7
186	121	VIVENDI UNIVERSAL	France	19.6
187	180	METLIFE (8)	U.S.	19.5
188	199	THOMSON	Canada	19.5
189	234	DOMINION RESOURCES (8)	U.S.	19.5
190	295	REPSOL YPF	Spain	19.3
191	93	MUENCHENER RUECK.	Germany	19.2
192	222	EAST JAPAN RAILWAY	Japan	19.2
193	187	REED ELSEVIER (8)	Neth./Britain	19.2
194	132	FORD MOTOR (8)	U.S.	19.2
195	204	COX COMMUNICATIONS	U.S.	19.2
196	220	STATOIL	Norway	19.1
197	261	FEDEX	U.S.	19.0
198	271	HENNES & MAURITZ	Sweden	19.0
199	384	INTERACTIVECORP (8)	U.S.	19.0
200	191	ILLINOIS TOOL WORKS	U.S.	19.0

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COMMENTARY

By Andrew Park

EDS: TELL IT LIKE IT IS, MR. JORDAN

Michael H. Jordan isn't usually the kind of CEO who avoids hard truths. After joining Westinghouse Electric Corp. in 1993, he wasted no time remaking the ailing conglomerate. Since replacing Richard H. "Dick" Brown at Electronic Data Systems Corp. in mid-March, Jordan pledged to act just as swiftly to steady EDS' ship. He knows he has to squelch fears that EDS is financially crippled. "It ain't true, but our competitors are making hay with it, and we have to deal with that in a straightforward manner," Jordan said during his first presentation to analysts on June 18.

But when it comes to EDS' finances, Jordan could be more forthcoming. At the June event with analysts, he presented forecasts that appear to be overly optimistic and aren't as easy to understand as some investors want. "I don't know if we've seen any true increase in transparency," says analyst Philip W. Ruedi of Baltimore-based T. Rowe Price Group Inc., which owned 3.4 million EDS shares at the end of the first quarter.

Consider EDS' forecast for the second quarter. On June 18, Jordan said free cash flow for the period would total $75 million to $125 million. But that figure left out one-time charges, including the costs of restructuring the company and laying off 2,700 workers. At the same time, the forecast left in a $98 million one-time gain from a court settlement with MCI and a spike in off-balance-sheet equipment leases. EDS says analysts want projections that way and that's how the company has done it in the past. But some think the numbers are unclear. "Cash out the door is cash out the door," says analyst Carol Levenson of newsletter publisher Gimme Credit Publications Inc. The peril of such accounting became clear two weeks later. On June 30, EDS reported that it wasn't going to receive the MCI payment in time to count for the second quarter after all.

Jordan's profit-margin projections aren't much easier to decipher. He says the company's "core operating margin" could reach 17% by 2005, a big jump considering EDS reported operating profits of 8.7% of revenue last year. But EDS says the new figure doesn't include underperforming software and consulting units or corporate overhead. "In this environment, you don't fool around with items of that ilk," says Paul R. Brown, past chairman of the accounting department at New York University's Stern School of Business. Jordan was not available for comment, but a spokesman says EDS is trying to give analysts more insight into its core business' profitability.

Jordan also insists he can produce double-digit operating margins even after subtracting overhead. Never mind that that would be better than IBM's industry-leading 9%-to-10% margin. Says Manoj Tandon of Pzena Investment Management LLC, an EDS investor: "I find it difficult to understand how you get [there]." Both Tandon and Ruedi say margins of 6% to 7% are more likely.

Granted, Jordan is just a few months into what he describes as a "multiyear task." He should be commended for pledging to eliminate percentage-of-completion accounting, a method for handling long-term contracts that allowed EDS to book revenues before it sent customers their bills. But he needs to do more. After facing questions about their disclosure, General Electric Co. and Computer Associates International Inc. improved transparency and were rewarded with higher stock prices, says NYU's Brown. Jordan should follow suit.

Park covers EDS from Dallas.

GET REALISTIC

CEO Jordan has been on the job just three months, but already investors are demanding more clarity and more realistic projections:

EARNINGS Sales are slowing and EDS is losing money on some major contracts, yet Jordan says he's sticking by his forecast for modest second-quarter profits. Trouble is, he says he'll include a one-time gain while excluding a number of one-time charges.

CASH FLOW Jordan says EDS can throw off $500 million in free cash this year. But that's only because of a spike in off-balance-sheet financing—and doesn't include restructuring costs or dividend payouts.

ACCOUNTING A new rule will force EDS to refigure revenues on big contracts. Yet after months of study, Jordan is still vague about the resulting charge, saying it will be from $600 million to $1.8 billion.

MARGINS Jordan says EDS' core operating margin will reach 17% by 2005, up from 8.7% last year. But he's leaving out "corporate overhead," which would shrink that by nearly a third, as well as underperforming businesses.

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TOYOTA

WHAT'S AHEAD FOR HP'S CASH COW

HP's $20 billion printing division contributed 28% o 2002 sales and 1(of operating profits company boasts n 40% of the worldw printer market and half of the lucrativ U.S. ink market. B faces a growing nu of challenges.

PRINTING BOSS JOSHI I A 23-YEAR HP VETERAN

PERIPHERALS

CAN HP'S PRINTER BIZ KEEP PRINTING MONEY?

A growing market and HP's relentless innovation should fend off rivals old and new

If Vyomesh Joshi, head of Hewlett-Packard Co.'s $20 billion printer business, is a man on the hot seat, he sure isn't sweating. On June 23, Dell Computer Corp. redoubled its year-old onslaught on the printer market by launching three new products, undercutting HP's pricing by at least 10%. But just days later, as Joshi soars across the sky in a five-seat corporate jet high above the beaches of San Diego, he is the picture of confidence. Clad in black slacks and a deep-blue dress shirt, he leans forward in his leather chair and looks incredulous that anyone could believe Dell is a threat to his business. "I'm very confident in our situation," he says, waving his arms to punctuate the point. "Innovation is still important in this business."

There are abundant reasons for his self-assurance. With nearly 40% of the worldwide market, HP's printer business has singlehandedly carried the computing behemoth through several tumultuous years. Dubbed the company's "crown jewel" by CEO Carleton S. Fiorina, Joshi's division chipped in 28% of HP's $72 billion in sales in 2002 and 105% of its $3.1 billion in operating profits—other units lost money. The cash cow stabilized HP's passage through the tech downturn, not to mention last year's controversial acquisition of Compaq Computer Corp. "It has been everything for HP over the last two years," says Bear, Stearns & Co. analyst Andrew J. Neff.

Can Joshi keep printing money? The odds are in his favor. HP is investing heavily in innovative printers and inks and should be able to stay ahead of rivals. And the market continues to sho robust growth, especially in lucrati niches such as digital photography.

Still, HP's printer business is facing growing number of obstacles. Dell b gan rolling out lower-priced printers la September and vows eventually to app the margin-busting business model th worked so well in PCs to the printer b At the same time, growth trends a moving away from HP strongholds, su as black-and-white laser printers, whe HP claims 70% of the market. Instea consumers and businesses are buyi more color printers and all-in-one devic that can print, fax, scan, and copy—ma kets where HP faces tougher competiti from Canon, Lexmark, and Xerox.

Meanwhile, long-term hurdles a cropping up in HP's lucrative ink bu ness. Customers typically spend twice

ENGE	RESPONSE	BOTTOM LINE
L FACTOR ember, Dell began selling suggesting that t will apply n-busting model to et.	**INNOVATION MATTERS** By spending $1 billion in annual printer R&D (more than Dell's entire R&D budget), HP is betting it can prevent printers from becoming commodities.	**NOT A BIG THREAT** Dell's direct-sales model doesn't fit the printer biz well: Consumers are used to buying ink in stores, and printer components aren't as standardized as PC components.
RKETS s are migrating n black- printers, where st dominant, printers and print, copy, fax, units.	**NEW-PRODUCT BLITZ** HP is uncorking 100 new printer products this fall, in a move internally dubbed "Big Bang II." The idea: Offer the most complete range of products in these growth markets.	**NOT TO WORRY** Already a leader in many of these strengthening printer markets, HP should solidify its standing by the end of this year.
L Parliament has gislation that ce printer makers ate by 2006 bedded in ink ; that make them efill and reuse.	**DEFUSE THE ISSUE** Increasingly, HP and its competitors are marketing cartridges for which only the ink needs to be replaced when it runs out—not the entire cartridge.	**A FUTURE THREAT** While not an imminent concern, the EU ruling is a symptom of a growing backlash over the cost and environmental impact of printer supplies that could one day hurt HP.

ich on ink cartridges and toner than the actual printer over the life of product. At HP, inkjet supplies carry % profit margins and generated $2.2 lion in operating profits last year—er 70% of the company's total. But yers and legislators are beginning to volt, distressed at the cost and envi-nmental impact of zillions of discarded cartridges. The European Parlia-nt passed a bill late last year that uld force manufactur-s such as HP and Lex-ark to eliminate by 06 chips in their ink rtridges that some-nes hinder customers m refilling and reusing e cartridges. Says for-r HP printing exec and w Quantum Corp. CEO k Belluzzo: "Animosi-can build up when ople think you have a k on them that's leading to increased icing."

ALL IN ONE: *Officejet 4110*

Despite the challenges, Joshi is weav-g an ambitious plan that he believes ll keep the printer unit ahead. Lever-ing the $1 billion HP spends annually printer research and development ore than double Dell's total R&D budg-), HP will deluge the printer market is fall with 100 new products, from gher-speed inkjet printers to better-rforming all-in-one units. At the same time, Joshi is going after new growth opportunities, such as the digital-printing-press market, which it entered through its 2002 acquisition of Indigo. HP also is ramping up a 400-person printing-and-imaging consulting team that helps companies efficiently manage documents across an organization and lower printing costs.

All told, HP expects its printing business to maintain double-digit growth in profits and revenues this year. "Out of the trillions of pages printed every year, only 4% go through HP devices," says Joshi. "The other 96% is our opportunity." Some analysts agree: Sanford C. Bernstein & Co. estimates that Joshi will be near his targets this year, with printer sales up 10%, to $22.4 billion, and operating profits up 9%, to $3.6 billion.

Joshi's plan is pivotal to HP's ongoing success. So far, the company has surprised many with how well it has integrated Compaq over the past 14 months. The merger has resulted in $3.5 billion in annual cost savings. Second-quarter 2003 profits of $659 million more than doubled the sum of HP and Compaq's year-ago profits. And shares have jumped 46% in the past year, to $21. But as Fiorina now endeavors to prove that the combined company can get growth revved up, she will need the printer cash cow as much as ever.

Joshi, a 23-year veteran of HP's printing business, has clearly sparked the organization since he took the helm two years ago. He exudes both enthusiasm and humility. When the 48-year-old native of India landed a job at HP in San Diego out of college, he had only $200 and a TV to his name—and had to rent an apartment across the street from work because he couldn't afford a car. Now, on a sweltering June afternoon the diminutive Joshi strides through the printer unit's Corvallis (Ore.) offices and throws his arm around managers. As staffers brief him, he fires off questions, doles out advice, and rarely lets one of them go without exchanging a high five.

Joshi has plenty of reason to smile. For starters, HP is the dominant player in an industry that is riding lucrative trends. Despite the digitization of information, people continue to print more and more pages. Market researcher IDC predicts that the number of pages printed will continue to climb at least 6% annually, to 1.8 trillion by 2006.

Ink consumption is growing even faster. With digital cameras surpassing traditional cameras in sales earlier this year, printers have emerged as the film developers of the 21st century. Color prints, which are about four times more expensive than black-and-white, are expected to jump to 30% of office printouts by 2007, up from 10% today, according to Gartner Dataquest. This bodes well for HP, whose market share for U.S. ink supplies has grown from 51% to 56% in the past three years.

Beyond ripe market conditions, HP is in a strong position to stave off competitors such as Dell. The PC market is based on standardized components—Intel's chips, Microsoft's software—so manufacturing efficiency, Dell's real strength, is of paramount importance. But innovation in the printer industry is widely dispersed and closely held among various competitors. So Dell, which sells printers made by Lexmark International Inc., can't turn the printer market on its head unless it owns and improves its own technology. And that seems unlikely. Printer makers, including HP, typically pour 5% to 6% of revenues into R&D, vs. the 1% to 2% invested by Dell. "Printer technology isn't standardized enough to make it work in Dell's favor," says analyst Steve Baker of market researcher NDP Group.

Dell concedes that it will take several years to penetrate the printer market, but execs such as No.2 Kevin

Rollins say they expect to have a "market-changing" impact eventually. "We know a lot about customer satisfaction and how to deliver quality products at competitive prices," says a Dell spokesman.

HP also has been moving quickly to meet shifting tastes among printer buyers. Xerox and Canon have trounced HP in the highest-performance, all-in-one printer market—HP has only 1% of the market for machines over $2,000. But elsewhere HP has adapted and innovated. It claims 52% of the market for lower-end, all-in-one inkjet machines. Over the next two years, the lower-end market is expected to soar 113%, to $2.5 billion, while the high-end market is projected to grow 31%, to $10.2 billion, according to Gartner Dataquest.

HP's biggest long-term worry is the little-understood threat to its ink business. While the European Parliament's actions present little imminent danger, it's a symptom of rising dissatisfaction with the cost and environmental impact of supplies. Already that discord is surfacing in the fast-growing cottage industry of refilling and reselling ink cartridges. Lyra Research Inc. predicts the aftermarket will grow to 30% of the $15 billion U.S. market for toner and cartridges in 2006, up from 21% this year. That will put pressure on HP's profits in the years ahead. "The writing's on the wall," says Meta Group Inc. analyst Steve Kleynhans. "The current model of printer supplies won't continue beyond a couple more years."

Joshi is carefully hedging HP's bets. On one hand, the company is delivering some products that let customers replace only ink, not the entire cartridge, when it runs out. On the other, he's betting that ink presents an opportunity for innovation. HP has dozens of chemists on staff who study the effects of ozone and pollutants on ink molecules. For its high-end photo-printing products, HP is promising images won't fade for 73 years. That, it claims, is more than double the image permanence of traditional photos and 10 times that of prints from rivals Dell and Lexmark. "They don't have this kind of investment," says Joshi.

Meanwhile, Joshi & Co. are branching into new businesses, such as Indigo's digital publishing. While these refrigerator-size digital-printing presses generated only $200 million for HP in 2002, Joshi expects Indigo to contribute $1 billion by 2006.

That's the kind of innovation Joshi and HP are banking on to keep their printer business second to none. Rivals may be eyeing the lucrative market, but Joshi is still flying high.

By Ben Elgin in Corvallis, Ore.

BIOTECH

THE OUTCRY OVER 'TERMINATOR' GENES

Critics fear such safeguards present fresh genetic perils

SACRAMENTO

Farmers and other groups protest an Agriculture Dept. conference, citing environmental and safety worries

On June 24, Iowa farmer George Naylor and a dozen of his friends dumped 100 pounds of feed corn and seeds near a busy intersection in Sacramento. They did it to thumb their noses at the Agriculture Dept., which was staging its first-ever conference nearby on genetically modified food. Agriculture officials were promoting new technology designed to improve food production worldwide. The protesters, however, weren't buying it, explains Naylor, president of the National Family Farm Coalition. "We have safety questions," he says. "We have environmental questions."

So do many others. The three-day conference drew thousa of protesters—who bloc traffic, staged hun strikes, and marched d the streets of Californ capital dressed as ki tomatoes. Indeed, scatte groups of environmen ists and farmers have b marching since the m 1990s, when corporations such as M santo Co. started tweaking the ge of common food crops to make s oddities as corn that's resistant to pe Critics worry that newfangled crops creep into the wild and cross-pollin with natural species, potentially d aging plant diversity and maybe e endangering the people who eat th But what makes today's protesters ferent is that they also abhor the h

ch solutions biotech companies are de-
loping to prevent the spread of al-
red species. Among these innovations
e "Terminator genes," named by crit-
s after the Arnold Schwarzenegger
aracter who is again blasting into the-
ers this month.

The debate will only grow louder as
e market for futuristic foods blossoms.
gricultural scientists are cooking up
ch inventions as corn with low con-
ntrations of unhealthy fats and salmon
at grow twice as fast as normal. And
me companies are devising methods to
ow pharmaceuticals and industrial
emicals in plants. All told, analysts
timate the market for biotech crops
ill expand 18%, to $5 billion, by 2005.

For the promise to be fully realized,
ough, the agriculture industry must
ure out how to prevent what critics
ll Frankenfoods from wreaking havoc
the natural food chain. Otherwise,
e world could see endless replays of
e 2000 StarLink incident, when ge-
tically modified corn not intended for
man consumption found its way into
co Bell products.

One of the first potential solutions
as proposed in 1998 by the Agriculture
ept. and Delta & Pine Land Co., a
ott (Miss.) seller of cotton and soy-
an seeds. They worked together to
velop a concoction of chemicals and
nes that prevents seeds from propa-
ting after the first harvest. "It dis-
pts germination," explains Dr. Harry
Collins, vice-president for technology
ansfer at Delta & Pine Land. He pre-
cts it will take a further four years or
to perfect the system and win regu-
ory approval.

Some farmers' advocates have loudly
jected this "Terminator" sterilization
ethod. They fear the technology will
ve all makers of genetically modified
ed a built-in mechanism to ensure that
stomers can't replant once they har-
st a crop. Monsanto enforces such a
olicy today by requiring customers to
n contracts—an extremely contro-
rsial practice that detractors say
aces a burden on small farmers, espe-
lly in developing countries, by forcing
em to buy new seeds every year.
Saving seeds is a fundamental human
ght," says Jean Halloran, a policy di-
ctor at the Consumers Union.

Some scientists are developing se-
nels to the Terminator—new technolo-
es that would both protect the envi-
nment and keep seeds fertile. One
ch effort is under way at Agriculture
d Agri-Food Canada, an environmen-
l group in Ottawa. Researchers there
gured out how to get plants to over-
oduce a hormone that ensures that if
llen from genetically modified crops
ifts to other species, the resulting seeds won't germinate. Under this scheme, when two plants containing the same mechanism are crossed, the lethal action doesn't kick in, and the seeds remain fertile. The group is now testing the system in canola and tobacco.

It isn't just reengineered vegetables that need to have their reproductive urges controlled. Environmentalists are also worried about fish that have been fashioned to possess superior traits—and fish farmers are sensitive to their concerns. At Aqua Bounty Farms Inc. in Waltham, Mass., salmon grow at twice the normal speed, because they have an extra gene that causes them to produce all year round a growth hormone that is normally seasonal. Nobody wants these critters to pass on their engineered traits to wild fish.

For one thing, a species that matured quickly might outbreed all other varieties, leading to less biodiversity and to a dominant species that may have other unknown traits. Because farmed fish excel at wriggling out of their sea pens, Aqua Bounty borrowed a trick, also used by trout farmers, to ensure that its salmon can't cross-breed: The company places all its eggs in a high-pressure environment, which causes the fish to be born with an extra chromosome, rendering them sterile.

The protesters needn't be worried about bioengineered fish quite yet. The Food & Drug Administration is putting Aqua Bounty's salmon through the same review process it uses for new animal drugs—a much more rigorous test than genetically modified plants must pass. Aqua Bounty founder Elliot Entis has been working with the FDA since 1995, providing data to prove that his fish have the same hormonal and nutritional makeup as normal salmon, with no extra allergy-causing ingredients. Entis hopes to get an answer from the FDA within a year. And he respects the concerns the environmentalists express. "When you start playing with the food supply, people get nervous," he admits.

The need to calm those fears couldn't be more urgent. The European Union has imposed a partial ban on genetically modified foods, prompting the U.S. to file suit with the World Trade Organization in May. The Farm Labor bureau estimates that the U.S. is losing $300 million a year in agricultural sales because of the moratorium. So while costumed protesters were marching down the streets of Sacramento, President George W. Bush was on the other side of the country at the Biotechnology Industry Organization's conference in Washington, where he scolded foreign leaders for rejecting genetically modified crops. He lamented that "the great advantages of biotechnology have yet to reach [the countries] where these innovations are now most needed." Without new technologies for controlling altered crops, it will take more than Presidential support to get these useful products on the world market.

By Arlene Weintraub in Los Angeles, with Pallavi Gogoi in Chicago

BIOTECH CORN: *Some modified strains can't be reused as seed*

CURBING DANGERS

Environmentalists want to prevent gene-modified plants or animals from drifting into the wild and reproducing. But some proposals to prevent such contamination raise their own thorny issues:

"TERMINATOR" GENES

Inserted in genetically altered plants, they cause the seeds to become sterile. But farmers gripe that losing the ability to replant seeds will saddle them with excess expenses.

INFERTILE FISH

"Super salmon" grow much faster than normal. Adding an extra chromosome prevents their ovaries from producing eggs. But critics fear the process may not be 100% effective.

"GENE GUARD" SYSTEM

Inserted genes prevent engineered crops from cross breeding with any natural strains. The plants can produce viable seeds, pleasing farmers. But development is years away.

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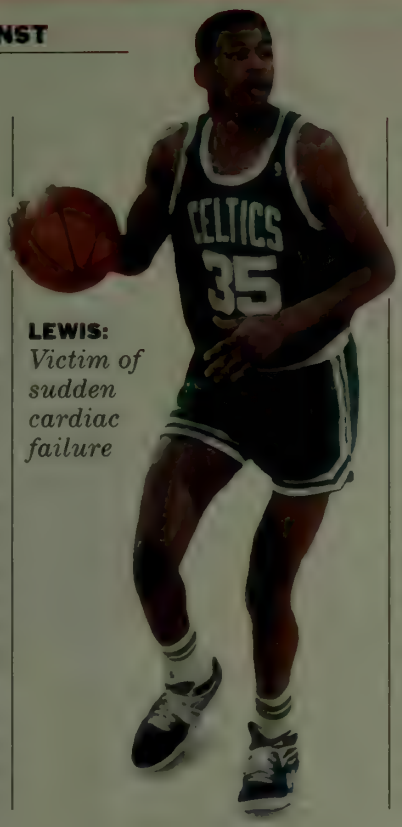
ITED BY CATHERINE ARNST

LOCKING LEAKY ALCIUM CHANNELS THE HEART

E PUBLIC IS ALWAYS ocked when a young ath-e, such as Reggie Lewis of Boston Celtics or Russian ure skater Sergei Grinkov, s of a heart attack in mid-rkout. Questions are in-tably raised about the vic-'s lifestyle—which can be actor. But a Columbia Uni-sity research team has nd new evidence that a netic defect can bring on ne cases of sudden cardiac ure.

Every time the heart con-cts, calcium needed for ooth beating is released ough channels in the heart cells. Excess calcium, though, can cause the heart to beat irregularly until the muscle wears out. Columbia physiologist Dr. Andrew R. Marks and his team, reporting in the journal *Cell*, identified a gene that stabilizes the opening and closing of the calcium channels. They then engineered a strain of mice that lack this gene—and found that their channels often got stuck in the open position. The mice consistently exhibited exercise-induced irregular heartbeats, which can lead to heart failure. Marks says the discovery points the way to therapies for those with a defective gene and the millions who have leaky calcium channels as a result of heart disease. ■



LEWIS: *Victim of sudden cardiac failure*

AXING REMEDIES FROM NICOTINE

E WAY TOBACCO ACTS ON s in the body may inspire dical advances—even as it tinues to kill people who oke it. Some studies show t nicotine may protect inst both Parkinson's and heimer's diseases, and can boost memory. Now, doc-s say, it may be possible design drugs that retain enhance nicotine's benefi-properties while ditching effects, such as addiction. Targacept, of Winston-em, N.C., was spun out R.J. Reynolds in 2000 to search for nicotine-related drugs. Scientists at Targacept and elsewhere have discovered that there are 17 genes for so-called nicotinic receptors in the body—docking sites on the cell surface that attract nicotine. The genes can combine in different ways to create receptor subtypes, many of which regulate brain-signaling chemicals, or neurotransmitters.

The trick for researchers is to create drugs that hit just one receptor subtype and miss the others. To screen drug candidates, Targacept scientists have developed a number of cell lines, each of which makes different receptor subtypes. The result is a full pipeline of drugs. One targets receptors in the colon and is now in Phase II trials for ulcerative colitis. Another is a powerful painkiller, and another is a potent memory-enhancing compound, says CEO J. Donald deBethizy. Human trials for the memory-enhancer are scheduled to start in September. *John Carey*

UNLIKELY BEDFELLOWS VIA NANOTECH

THE ABILITY TO BUILD NEW materials from scratch could be the principal benefit of nanotechnology, ushering in a time when researchers no longer have to make do with the stuff in nature's pantry. As evidence, there's the breakthrough described in the June 26 issue of *Nature* by researchers from IBM, Columbia University, and the University of New Orleans. They coaxed two unlikely partners to assemble themselves into a three-dimensional crystal designed to provide a combination that doesn't exist naturally: magnetism plus light-generating properties. This unique blend stems from nanoparticles of iron oxide surrounding lead selenide, a semiconductor that can emit light. A material that merges magnetic and optical properties could be tomorrow's silicon. And if this one doesn't work, the new self-assembly technique could combine almost any other mix of ingredients. *Otis Port*

INNOVATIONS

Herb-infused wrapping pa-? It isn't for eating—it's for ping. Researchers at hnion-Israel Institute of hnology have discovered t when traces of basil ex-t are added to plastic pping, the herbal essence vs the growth of a variety harmful bacteria that can il food. The study, pub-ed in the *Journal of Agri-ural & Food Chemistry* in , found the basil wrap ex-ded the shelf life of cheese without passing any basil flavor to the food. The wrap should offer similar benefits for baked goods, fish, fruits, meats, and vegetables.

■ Scientists know that many illegal drugs, as well as alcohol, can cause irreversible brain damage. But according to a recent study, marijuana poses no such threat. Researchers from the University of California at San Diego compared the mental performance of 704 long-term pot smokers, who were tested while not high, with 484 nonusers. They found that even heavy marijuana use did no permanent harm to a variety of key functions including language, reaction time, motor skills, or perceptual and reasoning abilities. The only exception: a small decrease in the pot smokers' ability to learn new information. The findings, published in July's *Journal of the International Neuropsychological Society*, suggest that short-term use of cannabis for medical purposes is unlikely to cause harmful side effects. *Adam Aston*

TOKING: *Long-term effects on brain may be slight*

THE DIGITAL AGE PRESENTS

HOLLYWOOD HEIST

Will Tinseltown Let Techies Steal The Show?

★ By Ronald Grover & Heather Green ★

Premiere day was fast approaching for *The Hulk*. The film's budget had already climbed to more than $150 million, including an extra $20 million for George Lucas' special effects company to give the giant green hero an extra dose of ferocity. Even the red-carpet ceremony was in flux, with a last-minute move at the insistence of director Ang Lee from historic Grauman's Chinese Theater to the Universal Amphitheater, where the sound was sharper. But that 11th-hour nitpicking was nothing compared with an earlier uproar at Universal Pictures: Two weeks before *Hulk*'s June 20 release, pirated versions of the blockbuster hopeful were already circulating on the Internet after a New Jersey man got his hands on an early copy and surreptitiously posted it on the Net. Worse yet, the film was getting nasty reviews from disappointed sci-fi buffs.

For Hollywood moguls, that script is more terrifying than anything they could ever put on the big screen. More and more, the first showings of the latest Julia or Mel flicks aren't in just the local cineplex. They're on KaZaA, Morpheus, or iMesh, Internet sites known mostly for music file-sharing but now snapping up pirated movies with remarkable ease. Within a few days of Keanu Reeves battling his first black-suited bad guy in theaters in *The Matrix Reloaded*, an estimated 200,000 folks had already taken in the action, according to an online rating agency, down-

COVER STORY

WHAT'S SPOOKING MEDIA MOGULS

Digital technology and the Internet are disrupting Tinseltown's control over how its movies and TV shows reach viewers. Here's a look at some key technologies threatening its way of life—and what studios are doing about it:

Data: *BusinessWeek*

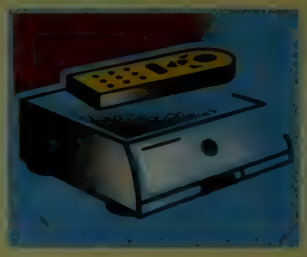
loading the long-awaited sequel in their dens and dorms. New episodes of HBO's hit *Six Feet Under* are on the Net, too, and you needn't be a computer whiz to find them.

It's all too reminiscent of the monster that ate the music business. For a town that loves a good sequel, that's one repeat performance Hollywood isn't keen to produce. Only five years ago, music sales were booming. Today, the industry is nearly paralyzed by piracy. Illegal downloads and file-sharing were partly responsible for last year's loss of an estimated $2.6 billion in worldwide music revenues, about 8%, says PriceWaterhouseCoopers. The speed at which music was brought to its knees makes Hollywood execs tremble. "We may not be the smartest guys around," says Peter Chernin, president of News Corp. "But we'd have to be brain-dead to ignore what it did to those guys."

Can Hollywood avoid getting Napsterized? Right now, the pirates are only nibbling at the $65 billion-a-year film and TV business. Downloading a movie is still a clunky affair that can take a few hours, and only 27% of the country's 66 million online homes have the superfast broadband connections to do it. Most of the piracy so far is through good old-fashioned counterfeiting. The ripping and burning of movies to DVDs is growing into a global underground industry that last year cost film studios an estimated $3 billion in lost DVD sales. It's prodding the guys in Guccis into action: Security folks outfitted with night goggles routinely patrol press screenings, searching for illicit camcorders. Former FBI agents are leading raids of illegal DVD copying plants in Thailand and Malaysia. Industry lawyers are flooding court dockets with lawsuits against all manner of thieves (page 82).

But the digital threat is looming as ominously as the thick flock of crows gathered on the jungle gym in Alfred Hitchcock's *The Birds*. Technology is coming on quickly that will make the prospect of copying movies and TV shows much more tantalizing—and far easier. Already, some 600,000 copies of films a day are being downloaded illegally, according to industry estimates, which could cost Hollywood hundreds of millions of dollars in lost video sales. A new crop of gizmos, from digital televisions to personal video recorders (PVRs), will soon make duplicating anything on the tube—from Fox Broadcasting Co.'s *24* to the latest Jennifer Lopez flick—a couch potato's dream. And within three years, half the online population will have broadband, making it easier to pass programs captured in digital form around on the Net.

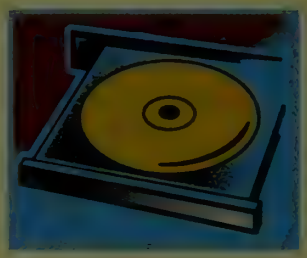
The living room is center stage for all this new digital entertainment. But will it be a war zone or a thriving marketplace shared by the creators of content and the makers of the cool machines that deliver it? That's the urgent question facing studio execs. It's not that they can't envision a rosy scenario for convergence, where there's money to be made at every turn—from movies on demand to *Sex and the City* fans streaming their favorite episodes on the PC to teens watching



PERSONAL VIDEO RECORDERS

Consumers can record hours programming, speed or skip through commercials, and m DVD copies. Although pione by startups TiVo and ReplayT in 1999, established giants from Sony to Hewlett-Pac are now cramming the technology into their computer and digital video players.

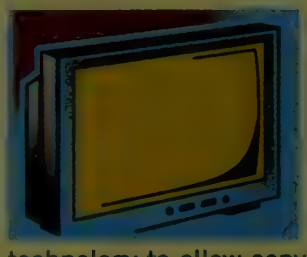
IMPACT	REACTION
HUGE Drives a stake in the heart of the advertising model. And does away with the notion of prime time: Viewers can watch anything anytime they choose. Ad zapping could cause ad revenues to drop by 19% within four years, according to Forrester Research.	Studios and networks to prevent automatic skipping and online sh They are also pressuri and consumer-electron companies to devise remedies that would r skipping, delete shows a period of time, and the size of hard drives



DVD BURNERS AND RECORDERS

Like CD burners, DVD burne becoming standard fare in computers. DVD recorders fr companies including Philips Panasonic that allow viewers copy directly from TV are also gaining in popularity.

IMPACT	REACTION
SIGNIFICANT Consumers can build their own archives of shows instead of buying or renting DVDs. The number of stand-alone DVD recorders sold annually will more than quadruple, to 17.4 million, by 2005, estimates In-Stat/MDR.	Studios sued an outfit 321 Studios, which le people make backup c prerecorded DVDs. On agenda: Set-top boxes would make only one digital cable and satel shows and prevent cop pay-per-view programs



DIGITAL TV

The FCC has required that a TV sets include digital recei 2007. Since 1998, 5 millio digital sets have been sold i U.S. Companies such as Th and Sony are also working o technology to allow copying from the new TVs.

IMPACT	REACTION
NO BIG WORRIES YET Digital shows are difficult to copy freely now, but with no protection in sets, rampant piracy of these near-perfect-quality shows is a concern.	Cable and consumer-el tronics outfits have neg tentative agreements fo set of copy restrictions including the broadcas now before the FCC.

ILLUSTRATIONS AND CHART BY RAY VELLA/BW

FILE-SHARING SERVICES

Although the music industry managed to shut down Napster, file sharing is flourishing on services such as KaZaA, Morpheus, Grokster, and iMesh. It still takes) download movies and about a half-hour for shows *ends*, but the more broadband is adopted, the easier et to share huge movie and program files.

IMPACT

ITIALLY BIG Could value of syndicated s, as well as sales of rded shows and Despite the iffy downloading puts e on film studios to ovies available online uickly after their release.

REACTION

Lawsuits against services were set back when a court sided with Grokster and Morpheus, saying customers, not the products, should be liable. Studios launched online services Movielink and CinemaNow, among others, to turn downloaders into paying customers.

CAMCORDERS

The copies can be blurry, but camcorders let professional pirates reproduce movies illegally in theaters upon their release. The recordings are then burned onto blank DVDs and sold on street . Copies are also posted on the Internet.

IMPACT

ICANT Such feits undercut the hain—from theater to premium cable—llywood set up to cash s movies, which cost age $90 million to nd market. But lousy still limits demand.

REACTION

Studios are working with the feds and local authorities in Asia, where much of the piracy starts. They're exploring embedding technology, called watermarking, on master copies of movies so camcorders won't work.

WI-FI

The next generation of Wi-Fi—making possible wireless connections between devices in homes, parks, offices, and even neighborhoods—rolls out this year. Because it's five times as fast as rent version, it can handle bigger files, such as video.

IMPACT

OWN THE ROAD it easier to copy out a home and to File-sharing networks undetected by ht cops.

REACTION

Studios are pressuring companies to design Wi-Fi for streaming, not for downloading copies to another device. Protection technologies are being developed.

videos on handhelds. "We would certainly like to be able to make our content [increasingly] available in a digital world," Comcast Corp. CEO Brian L. Roberts told the National Cable & Telecommunications Assn. convention in early June. "But we need to feel secure that we're going to get paid for [it]."

The next few months will be crucial for the Hollywood gang, who are currently wrangling with cable operators, consumer-electronics makers, and the technology industry over protecting their digital gold. Each group has its own philosophies about how much protection—mandated and voluntary—the content needs. Historically, working hand in hand with disparate interests has been anathema to the moguls, a single-minded, ego-driven bunch for whom compromise doesn't come easily.

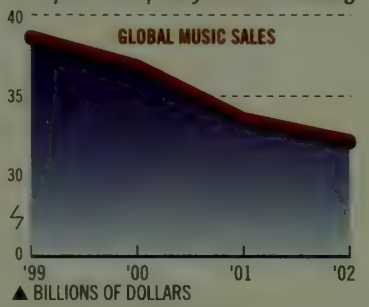
But for everyone's convergence dreams to come true, that must change. The studios are already taking tentative steps toward recalibrating their lucrative business model, which now guarantees earnings on every movie for months after release, as films cascade through theaters, video stores, and cable TV. They are testing new ways to serve up Hollywood fare faster and cheaper, with an eye to deterring Net pirates. And they are also inching toward key agreements with gadget makers over just how much copy protection will be built into new generations of TVs and cable boxes.

Looking ahead, retooling for the Net is the most important gambit, if potentially the most perilous. Execs are clearly energized by the early success of Apple Computer Inc.'s iTunes Music Store, which offers a road map for selling their wares online. At 99¢ apiece, more than 5 million songs have been sold in two months—in part because iTunes offers flexibility, allowing users to make copies they can move to other computers. The moguls see iTunes as proof positive that consumers are willing to accept limits on copying if the price is right. "[Apple CEO] Steve Jobs has liberated us," Sony Corp. of America CEO Howard Stringer told a group of media executives on June 25. "We will all be doing something similar."

Many studios are already laying the foundation for digital delivery. In fact, Hollywood is proving quicker in proposing an alternative to file-sharing than music ever was. That's critical because absent that innovative spirit, things could get grim. Consider projections made by research company Sanford C. Bernstein & Co. now reaching moguls' desks. Analysts there estimated what the blow to earnings would be at the big entertainment companies if in one year they suffered the same level of declines from piracy and file-sharing as the music industry. The results: At heavily movie- and TV-dependent Vivendi Universal Entertainment, operating earnings would fall 43%. Disney's would drop 17%; Viacom's and AOL Time Warner's, 4% to 6%.

NO SEQUELS, PLEASE

Hollywood is hoping to avoid the plight of the music industry, which has seen sales plummet in recent years, in part from piracy and file sharing



Data: International Federation of the Phonographic Industry

The impact of new technology will hit hardest over the next three to seven years, the report predicts, giving the media folks little time to adjust. "The message here is that the studios have to move faster," says Thomas R. Wolzien, one of the Bernstein report's authors. "They can't be like the music industry, deer-in-the-headlights for the past five years."

Hollywood still harbors some of music's protectionist urges, though. It is battering downloaders with lawsuits and pushing broad-brush copy-protection laws in many states—all of which could backfire with Internet-savvy consumers. Then again, grudging adaptation to technological change is nothing new in

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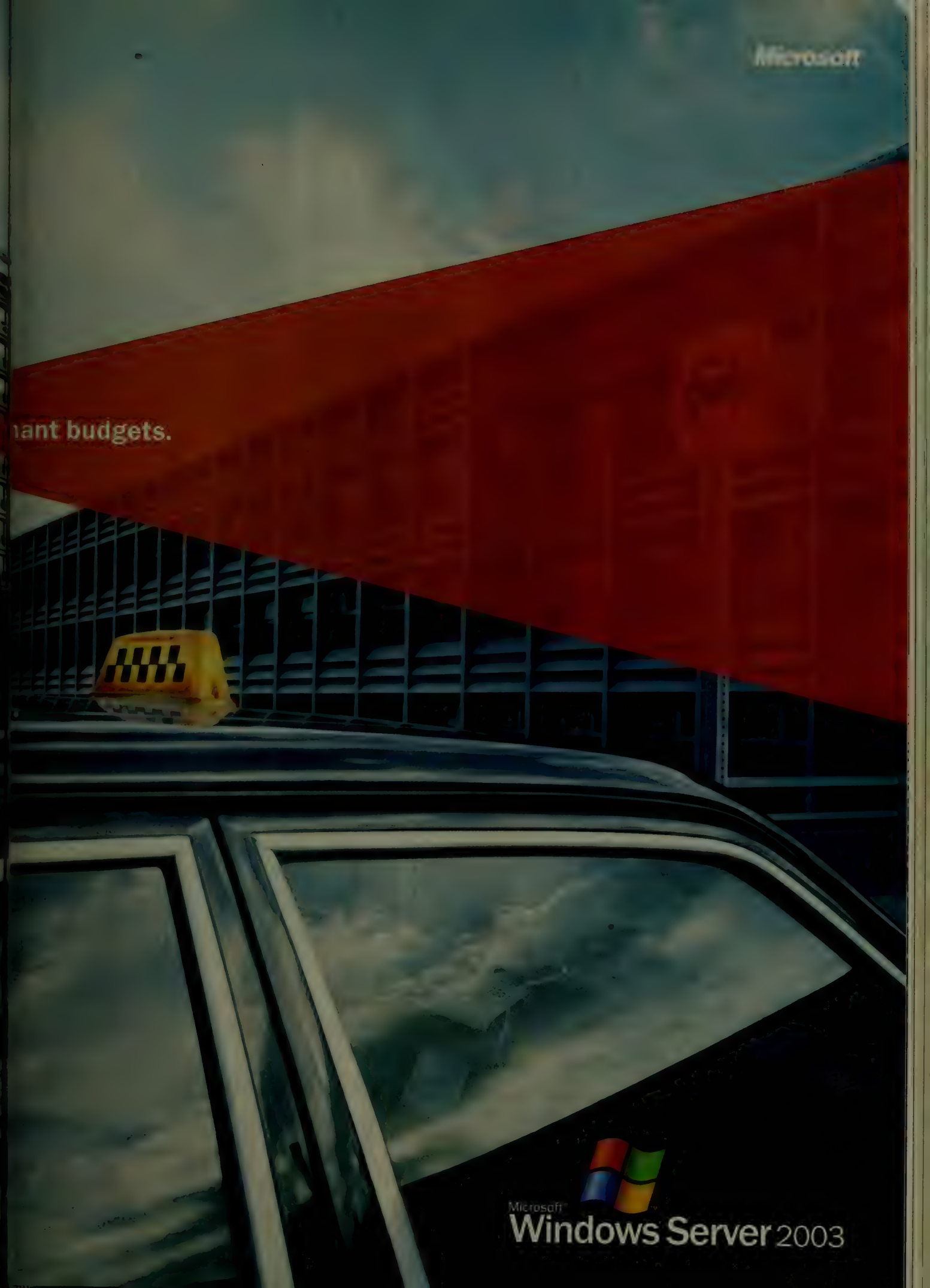
Microsoft
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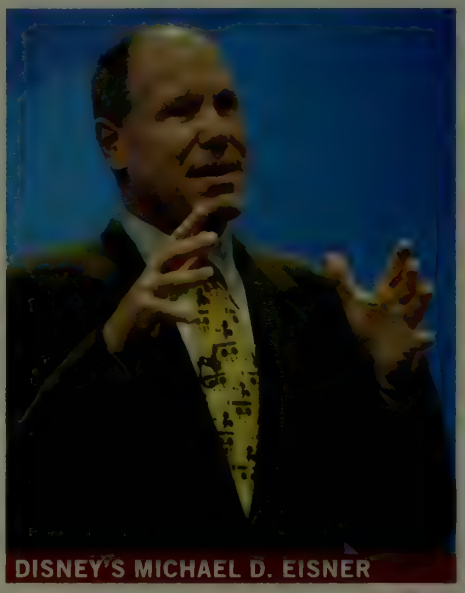
Microsoft
Windows Server 2003

the media business. Back in the 1950s, studio kingpins like Jack Warner refused to license films to TV, fearing a blow to the box office. But eventually studios embraced TV and subsequent technologies, from videocassettes to DVDs, and made bundles of money in the process. Today Hollywood takes in more cash from DVDs and home videos than it does from theaters, while the No. 1 video chain, Blockbuster Entertainment, is owned by Paramount parent Viacom Inc. This time around, though, there will be some bloody battles and financial setbacks as the new and even more disruptive technologies take hold. Still, Hollywood leaders seem ready to roll up their sleeves. "We not only need to work together within industries but across industries [for a solution] that touches not just the content creators but the software industry and the consumer-electronics industry," AOL Time Warner Inc. CEO Richard D. Parsons told the cable powwow. "Let's all work together to come up with ways of protecting this goose that's laying the golden eggs."

AOL'S RICHARD D. PARSONS

"Let's all work together to...[protect] this goose that's laying golden eggs"



DISNEY'S MICHAEL D. EISNER

"If we don't offer... our products in a timely manner, the pirates will"

Hollywood surely has been spinning gold lately. This year will see $11.4 billion in DVD sales, up 34% from 2002 and twice as much as in 2001. The industry thrives on a "windowed" distribution system, which maximizes revenue by stoking demand (table). Movies don't come out on DVD until five or six months after hitting theaters; premium cable gets them five or six months after that. Today, DVDs and videos supply about 50% of a film's revenues. But as more folks can click, copy, and transmit, they'll likely seek out new flicks on the Net rather than wait for local video stores to stock them.

Changing the model will be tough, as each sector clings to its piece of the status quo. "As much as they are loath to admit it publicly, the studios cannot afford to circumvent us," John Antioco, CEO of Blockbuster Inc., said in a recent speech. "They have too much to lose." Theater owners, too, are threatening revolt. When Fox recently announced plans to release DVDs of *From Justin to Kelly*, about the *American Idol* stars, just six weeks after its premiere, theaters refused to show the film. Their beef? That Fox was enticing folks to bypass theaters and go straight for the rental.

Yet even as the financial bennies of the old system still flow, Hollywood's moguls are learning some lessons from the record companies. The labels squandered the rollout of their own online services like MusicNet and pressplay by not having licensing agreements for all songs from all labels and by forcing a subscription model. By the time the Big Five music empires ironed out deals, pirated music had crushed them.

By contrast, Hollywood has already made inroads with pricing, variety, ar copy protection. Five Hollywood studi began offering movies through Movieli last November. And CinemaNow, ope ated by the independent film stud Lion's Gate Entertainment, began se ing films on the Web in early 2001 a recently has begun offering higher-vis bility films from MGM, Warner Bros., a Fox. CinemaNow allows some limit downloading of movies and gives co sumers up to 48 hours to watch ea flick before the file expires. The servi says it has 25,000 customers who p $9.95 a month—although many of the may have signed up to get adult film Sony Pictures Entertainment, throu its Web site SoapCity, offers Net dow loads of *The Young and the Restless* a *As the World Turns*, two long-runni soap operas it produces. They're availab the day of airing for $1.95 a show or f a $9.95 monthly sub. Down the roa Sony hopes to deliver programming its Vaio computer and handheld Clie.

Come this October, Walt Disney C launches tests of its MovieBeam servi which will deliver up to 100 movies month to folks in Salt Lake City, usi bits of the unused digital spectrum fro its ABC affiliate in that city to send flic directly to a Disney set-top box. "If don't offer consumers our products in timely manner," Chairman Michael Eisner said when he announced Mov Beam in April, "the pirates will."

Still, the movie sites have a ways go to win a mass market. Movielink do not include films from Disney or F CinemaNow boasts nearly 1,000 movies but has only abo 100 of Hollywood's recent hits. You can get the second *H ry Potter* or *Barbershop*, but you can't get the wildly popu *The Matrix*. The sites may also want to put more empha on their per-flick payment system instead of subscripti models, which online users don't like much. Another obstac Superstar directors like Steven Spielberg and George Luc who don't trust current protections, are refusing to licen their films to any Internet service.

Of course, the quality of online viewing is still iffy. Unli songs, which can be captured quickly and stored on portab players, downloading movies is glacial. And not everyo wants to watch them on a computer screen. Some execs figu that the less-than-desirable quality of pirated movies may b

THE STUDIOS' MONEY MACHINE

As things stand, moviemakers exploit staggered "window" distribution to wring the most from flicks. Digital delivery could subvert this lucrative model. Here's how the system works:

*2003 retail sales estimates
Data: PricewaterhouseCoopers

FIRST, THE MOVIES OPEN IN THEATERS...	...THEN, FIVE TO MONTHS LATER, THEY THE VIDEO STORE
BOX OFFICE REVENUES*	VIDEO/DVD SALES & RE
$10.0 BILLION	$23.8 BILLI

em some time. As the industry aps its Net strat- y, it's also trying shore up another lnerable front: gital TV. This is potentially huge urce of digital akage and wide- read copying ght smack in the art of the living om. Studios were lted awake in 01 when tiny NICblue offered ReplayTV Inc., a R that not only corded shows but o allowed con- mers to share em over the Net d even zap com- ercials. The stu- s faced down the reat by suing the mpany, whose owners deny liability; the t is still pending. ReplayTV's new own- s, who are not party to any suit, have reed to pull back on ad-skipping fea- es in new machines due out in August, t they'll still have a fast-forward button. Although PVRs have been slow to take , the number sold annually could adruple to 1.3 million by 2005, according the Consumer Electronics Assn. Near- 1 million of satellite operator EchoStar mmunications Corp.'s 8.5 million sub- ibers have PVRs with a 30-second skip button. TiVo has t-forwarding. With enough scale, such machines could set off irtual A-bomb on broadcast and cable networks' traditional vertising model, which brings in an estimated $30 billion a r. Indeed, ad viewing will drop by 19% by 2007, figures For- ter Research Inc. "It is the perfect storm of hardware de- es getting cheaper and more powerful and broadband ar- ing big-time," says Eric Garland, CEO of BigChampagne , which collects data on movie downloading.

Yet even as it grapples with PVRs, Hollywood is making ogress with makers of digital-TV sets. The studios and con- ner-electronics companies are circling in on agreement over w standards. New rules before the Federal Communications mmission would make it impossible to record broadcast TV shows, now delivered digitally, and ship them out onto the Internet. This would lessen the vulnerability of digital-TV shows sent over the air to the 20 million or so U.S. homes, about 18% of TV households, that don't have cable or satellite. Protection would come in a so-called broadcast flag, software in programming that tells TVs and recording devices whether the content can be sent over the Net.

An accord has also formed over what's known as the "plug-and-play" proposal, submitted to the FCC for review last December. This would build safeguards into set-top boxes, TVs, and PVRs that handle digital shows sent to the 80% of U.S. households receiving cable and satellite service. Consumers would be able to make as many copies as they like of broadcast shows like CBS's *CSI: Crime Scene Investigation*, only one copy of a cable show like HBO's *Curb Your Enthusiasm*, but no copies of pay-per-view offerings. Viewers can burn that single copy on a DVD, but if they try to make a second, the first goes blank.

But a contentious Hollywood wants more and may hold up a pact on plug-and-play to get it. It is demanding safeguards for the hundreds of millions of analog TVs in existence. And the studios' preference for regulation rather than a private-sector accord on the broadcast flag worries some tech companies. Fighting for market share in a harshly competitive market, the purveyors of PCs and other devices want as few restrictions as possible to entice buyers of their gadgets. By trying to lock in too many controls before cutting a deal, techies argue, Hollywood is alienating customers and slowing the growth of a huge new digital audience. "You need to do a number of things concurrently," says Andrew Moss, director of technical policy at Microsoft Corp.'s Windows division. "It's not a matter of stomping out all the piracy first and then enabling new distribution mechanisms later."

Indeed, Microsoft itself is maneuvering for a role as power broker on the digital entertainment scene, now that it has settled its browser battle with Internet rival AOL Time Warner. As part of its late May deal, Microsoft may license its copyright-protection software to Warner Bros. for its TV shows and movies. The software giant, along with Intel, is also developing Trusted Computing, copying controls built into the next generation of computers. Microsoft's push into digital-rights management shows how crucial technology is becoming in the battle to turn Hollywood's digits into dollars on the Net.

What if the pirates continue to run amok? More rigorous regimes for ensuring payment for copying would probably

HOLLYWOOD'S MOST WANTED

Little did Robert Moore know when he started 321 Studios Inc. in 2001 that he would be a lightning rod for consumers' digital rights. St. Louis-based 321's software allows people to protect their $19.95 investment in prerecorded DVDs by making copies before they're lost or damaged. To Hollywood, the software is no less than a tool for piracy.

That has sparked controversy over just what's permissible under the Digital Millennium Copyright Act, the 1998 law that's one of Hollywood's strongest weapons to combat piracy and keep control of content. While the DMCA recognizes fair use—the right to make copies for personal use—it also makes it a crime to crack codes used by copyright owners. Moore's software does exactly that, bypassing digital locks that are embedded in DVDs.

Hollywood wants the court to shutter Moore's company, but he sued in April, 2002, asking a California federal court to rule that his software does not violate the DMCA, pleading fair use. Critics say the DMCA's broad-brush restrictions harm innovation and consumers. The result of the lawsuit will set out critical new rules for the digital future.

Heather Green

321 STUDIOS' ROBERT MOORE

He says his software merely helps DVD buyers protect their investment

LOWED TWO MONTHS ATER ON CABLE AY-PER-VIEW...

REVENUES*

$2.2 BILLION

...BEFORE SHOWING ON PREMIUM CABLE CHANNELS A YEAR AFTER RELEASE

REVENUES*

$10.4 BILLION

Cover Story

emerge. Among them might be compulsory licensing, in which a Net service provider or a file-sharing service would track downloads and charge a fee at the end of the month. Prices could be set by industry groups or even the government, and the studios would get some slice of the revenue. Hollywood doesn't like this much, because it loses pricing control, but some tech groups back the idea. Another concept: a tax on blank DVDs, PCs, or PVRs. This would essentially be a piracy tax creating a huge pool of money earmarked for the studios. The tech companies see this as an unnecessarily blunt instrument that treats all users as pirates-in-waiting.

Media moguls are realizing that what they really need to do is turn pirates into paying customers. That's why, for a many in the industry, Apple's iTunes has become a demarca tion between eras. And this from execs who were recentl fuming about Jobs's "Rip. Mix. Burn" marketing blitz, whic seemed to them to promote piracy. Now Hollywood recognize his genius stroke: When it comes to entertainment, you hav to give the people what they want.

With Tom Lowry in New York, Catherine Yang i Washington, and Cliff Edwards in San Mateo, Calif.

BusinessWeek online

For more on Hollywood's digital future, read Q&A's with Viacom's Richar Bressler and Silicon Valley tech consultant Geoffrey Moore and a pane discussion among moguls at www.businessweek.com/magazine/extra.htr

TINSELTOWN'S AIM: TO CATCH A THIEF

Jim Carrey was there. So were Jennifer Aniston and Morgan Freeman. Far less visible at the May 21 premiere of *Bruce Almighty*, amid the moguls, stars, and fans, were the latest members of Hollywood's A-list: Rent-a-cops who patrolled the upper balconies at the cavernous Universal Amphitheater, prowling for pirates with camcorders.

Hollywood is in full crackdown mode for crooks who pilfer films by recording them at premieres and press screenings. Metal detectors meet most folks at these shows, along with stern signs warning against copying. As part of its ban on all electronic equipment, Fox Entertainment Group earlier this year barred cell phones at one screening. And Hollywood is developing jamming devices that will disable camcorders and other electronic gizmos inside a theater. "We take this very seriously. These are criminals we're talking about," says Fox Filmed Entertainment Chairman Jim Gianopulos.

More than 50 films were stolen this year before they were shown on screen, says the Motion Picture Assn. of America. Often, say MPAA enforcement officials, thieves get $10,000 apiece for the hottest films, which are then shuttled to crime syndicates in Taiwan, Thailand, and elsewhere in Asia, to be mass produced. Then the pirated DVDs are sold on the streets of Asian, European, and U.S. cities. The margins are huge. Counterfeiters can sell the DVDs, which cost 62¢ apiece, for as much as $15.

Studios, which lost an estimated $3 billion to counterfeiting last year, are also staging raids on DVD plants. The MPAA, working with a network of informants and local police, closed down 63 illegal factories in Asia this year, 12 in Malaysia alone. But prosecution is lax in many Asian countries because gangs threaten prosecutors and judges, says MPAA Asian enforcement chief Mike Ellis. Sentences can be light for those who are nabbed. Last year, a Singapore pirate caught with more than 2,000 pirated DVDs got 18 months.

PIRATED VIDEOS ON SALE IN CHINA

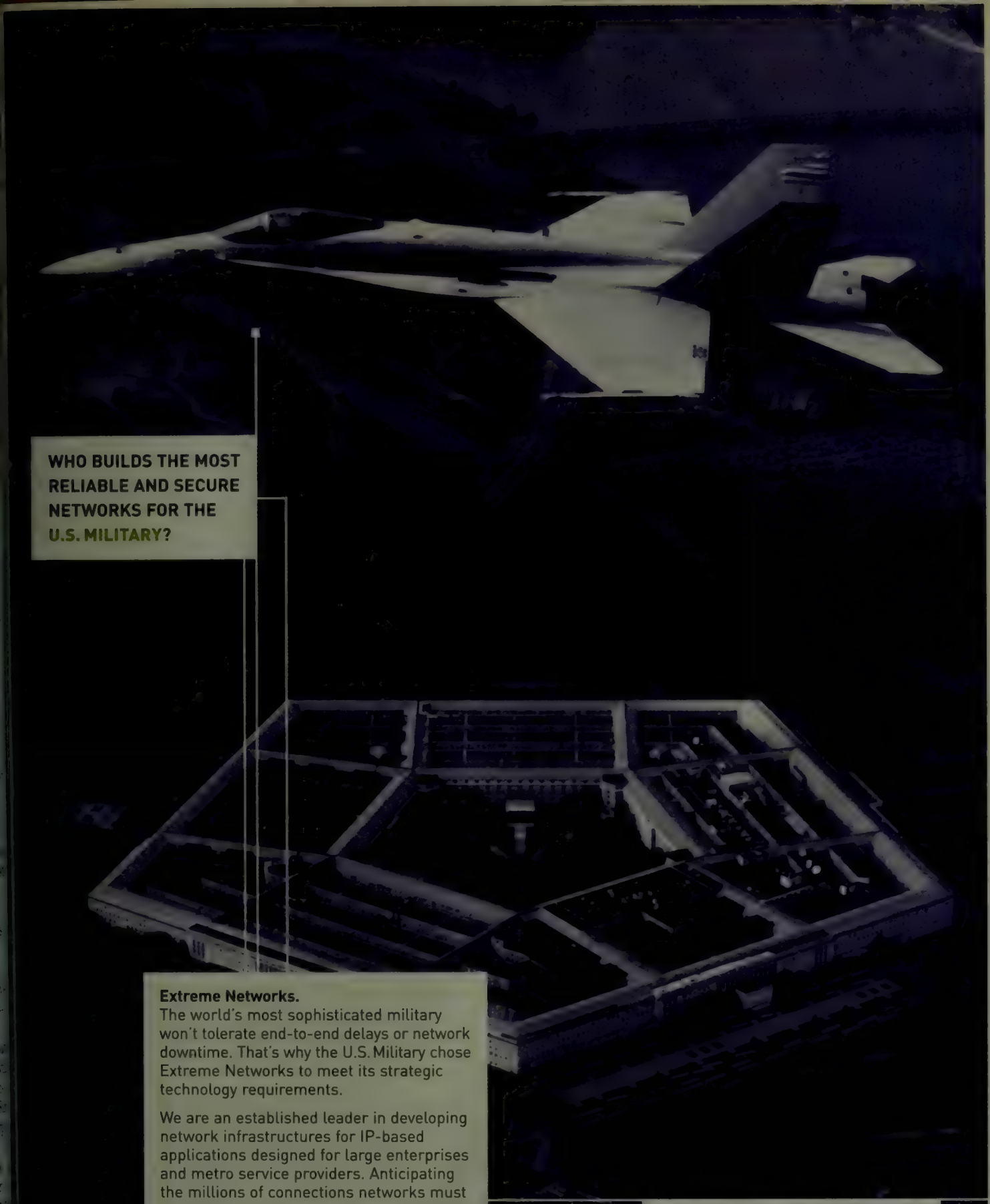
U.S. studios are cracking down on the criminals with camcorders who pilfer and duplicate first-run movies

Hollywood is making some headway in keeping films out of thieves' hands. In April, FBI agents nabbed a man camcording Paramount Pictures' sci-fi flick *The Core* at a media screening. In its most impressive collar yet, Universal and the FBI used a "tag" digitally embedded in *The Hulk* to trace a pirated version of the film to 25-year-old Kerry Gonzalez. The New Jersey man received the film from a friend at the studio's New York ad agency and put it on the Net weeks ahead of the movie's opening. Gonzalez, who pleaded guilty on June 25 to making an unauthorized digital copy, faces a possible maximum $250,000 fine and up to three years in prison. "We are sending a message here," says Universal Studios President Rick Finkelstein.

On the Net, studios intend to be even more vigilant. Hollywood's trade group plans to ratchet up a campaign to send out cease-and-desist letters to online pirate services: Last year it mailed 163,000 warnings and sent off so-called spoof movies to trip up pirates. The studios have resisted suing their customers directly, as the recording industry is now doing, but execs hope the music crackdown will be a deterrent for all pirates. "Litigation should scare people," says Sir Howard Stringer, CEO of Sony Corp. of America.

Hollywood has already begun to poke fun at its own plight. Earlier this year, a flood of DVDs, sent out to Academy Award voters, found their way onto the black market. Oscar host Steve Martin joked about it on this year's telecast, kidding that Meryl Streep had put her disks on eBay. The line got one of the biggest laughs of the night.

By Ronald Grover in Los Angeles



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WALL STREET

FRED JOSEPH IS BACK IN BUSINESS

The ex-Drexel chief has a firm that looks a lot like his old firm

If there's one thing to know about Frederick H. Joseph, it's that he is unrepentant. In fact, with his name (in brushed-silver type) on the door of a growing investment bank, he's even emboldened these days.

Joseph presided over the spectacular collapse of Drexel Burnham Lambert, which went from being Wall Street's most successful firm in the mid-1980s to its most infamous. Star trader Michael Milken embroiled Drexel in an insider-trading scandal that landed him in jail. The firm pleaded guilty to six felony charges and paid $650 million in fines in December, 1988. Two years later, it was bankrupt: Thousands of employees were out of work, and investors lost millions.

Unlike many of today's Wall Street chiefs, who have so far evaded punishment for scandals at their firms over analyst conflicts and public-offering payola, Joseph took a hit. He was prohibited by the New York Stock Exchange from taking a supervisory role at any of its companies for three years, banished as a Wall Street CEO for life, and disgraced among colleagues of some three decades.

DIFFERENT DEALS

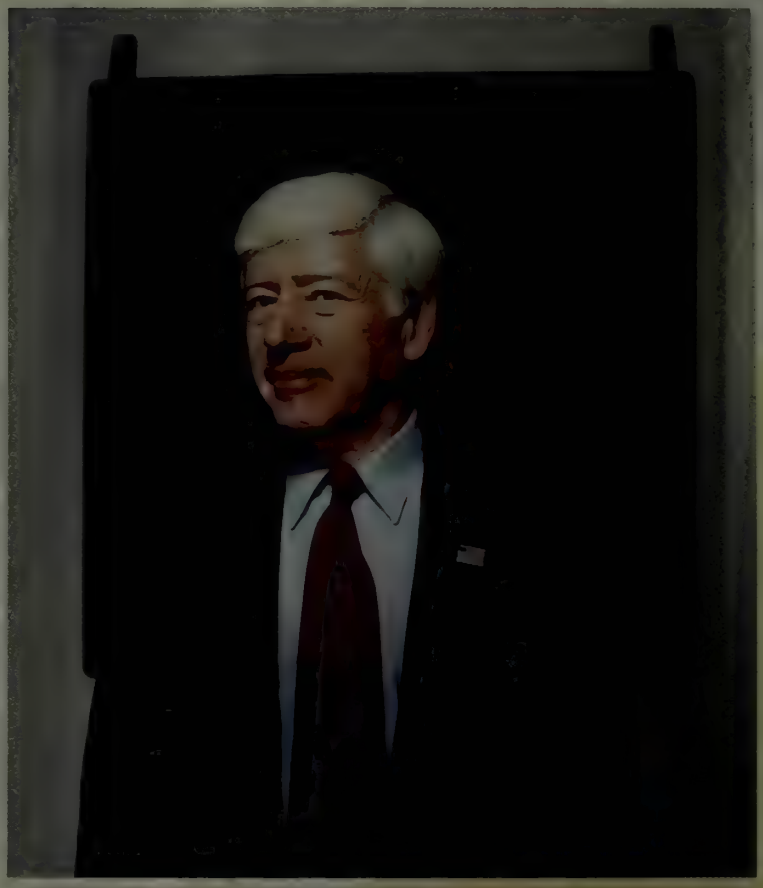
Milken went to prison. Joseph has hardly been out of work a day since Drexel's collapse

But Joseph has another take on the scandal. "There were all sorts of things that shouldn't have been done, but after the biggest investigation in history, they [the Securities & Exchange Commission] charged five or six out of 10,978 people, roughly," he says. "There were a few bad apples, and that's really bad. And you end up taking responsibility for that."

Joseph didn't skulk away from Wall Street, though. Actually, he has hardly been out of work a day since Drexel fell apart. During his three-year ban by the NYSE, he was a consultant for Drexel as the firm liquidated its holdings. From January, 1994, until May, 1998, he ran his own investment-banking consulting firm, Clovebrook Capital. From there, he became a senior adviser and managing director at ING Barings LLC, heading their investment-banking unit. When ING put that unit up for sale, Joseph tried to buy it with some other managers and big investors, but lost out to ABN Amro, an internation bank based in Holland.

That got Joseph and his backers thin ing about starting their own mid-tier i vestment bank by acquiring one. Th did just that, and in the summer of 20 the firm now called Morgan Joseph Co. was born. Morgan is John A. Morg the great-grandson of John Pierpont M gan and chairman of the new firm.

Joseph is building boutique in much the sa way he built Drexel: by nancing small and midsi companies neglected larger banking riva Deals from $20 million $100 million have, in fa been the fastest-growi part of a merger-and- quisition market that otherwise in the doldru



FREDERICK H. JOSEPH

BORN Apr. 22, 1937, in Dorchester, Mass.

CHILDHOOD Raised in lower-middle-class suburb where his father was a cab-driver and his mother was a dental assistant.

EDUCATION AB in English, Harvard College, 1959; MBA, Harvard Business School, 1963; Harvard

Boxing Club lightweig champ for three years

CURRENT POSITION Managing director and head of investment ba at Morgan Joseph sin tember, 2002. The "N is John A. Morgan, grea son of John Pierpont

NOTORIOUS PAST W CEO of Drexel Burnha Lambert when trader Milken became embr an insider-trading sca Milken spent 22 mon jail. In December, 19 firm pleaded guilty to felony charges and pa $650 million in fines years later, Drexel wa rupt, and thousands employees were out o Joseph was barred fro ing a supervisory posi the industry for three

FAMILY Married to L Anderson Joseph; fou daughters and one so from a previous marri

doubling as a percent of total deal volu in two years. In 20 months, Mor Joseph has inked 40 deals—restructuri and debt financings—worth $1 billio total, and 60 more deals wait in wings. He has more than doubled staff, to 109, and plans to grow fivefol five years. "I'm a deal groupie," he s from his Rockefeller Center office.

At Morgan Joseph, appearances n

July 2003

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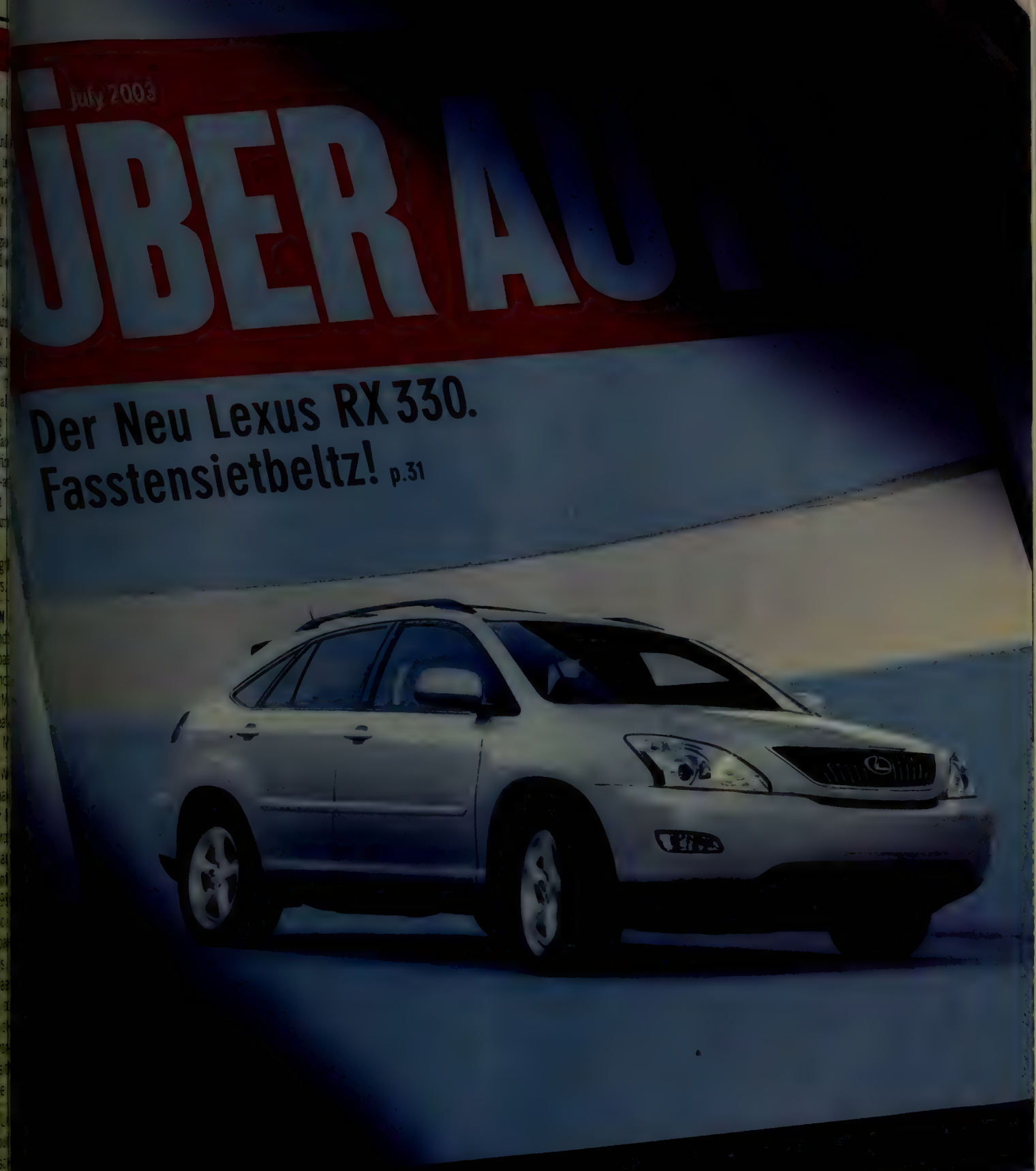
Fasstensietbeltz! p.31



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ter. They have to. Since Joseph is prohibited from holding the title of chief executive, there's someone else in that job: John F. Sorte, who replaced Joseph at Drexel in May, 1990, and is one of the firm's main investors. Today, Sorte oversees Morgan Joseph's research-and-equity trading operations as well as its high-yield-bond department, which is growing quickly. The firm's lifeblood are the bankers in New York, and they report to Joseph. Although Joseph is officially managing director and co-head of investment banking, he lists no title on his business card. When asked about Joseph's role at the company, Sorte says: "He's doing exactly what he can do."

Up from what he calls the slums of suburban Boston, Joseph was a tough kid but a good student. He earned a full scholarship ("there was no other way") to Harvard University in the late 1950s and went on to get his MBA there, too. He blossomed into a banker as the industry itself matured: When he was offered a job in the spring of 1963 by E.F. Hutton & Co. chief John Shad, it was only one of a half-dozen investment-banking jobs in existence. Then the father of two, Joseph worked relentlessly, making partner in five years. Eleven years later, he landed at Drexel Burnham Lambert as co-head of corporate finance. He became CEO in May, 1985, when the Dow Jones industrial average was 1,300—and Drexel was not yet a household name.

In the public memory, Joseph may still be the boss who missed some of the worst financial skulduggery of the 1980s. He certainly embittered a few Drexel veterans. According to a former senior officer, Joseph has never attended any of the firm's occasional reunions: "No one wanted him there. He was persona non grata for a while, and he is still controversial with Drexel people." A spokesman for Joseph points out that several former Drexel colleagues now work at the firm and that Joseph socializes with others.

On a recent afternoon on Manhattan's Fifth Avenue, Joseph ran into erstwhile archrival John H. Gutfreund, now managing director of C.E. Unterberg, Towbin, a New York investment-banking boutique. As former CEO of Salomon Brothers, Gutfreund was also forced to resign after trading scandals and was banned from leading a securities business. (Gutfreund, Joseph points out, had to pay a fine; he didn't.) They chatted briefly about their new jobs. "The Street allows you to do that. There's no rule that says you have to retire," says Joseph. "Experience is an asset, not a liability." That certainly seems to apply to the House of Morgan Joseph.

By Mara Der Hovanesian in New York

COMMENTARY

By Mark Hyman

UNSEEMLY? YES. BUT DON'T BLAME COLLEGES FOR CHASING THE MONEY

The question of the week for inquiring sports minds: Is the Atlantic Coast Conference just a bunch of artless, greedy swine or is it just a bunch of artless, cash-strapped colleges?

After mounting a corporate-style raid on the Big East conference to acquire three new schools and bring its total membership to 12, the ACC settled for two. It bagged the University of Miami and Virginia Tech—and the prospect of many more millions in football revenue.

MIAMI HURRICANE: Bye-bye, Big East

ACC officials deserve most of the darts coming their way. Their game plan had all the finesse of a recovered-fumble run by an overweight nose tackle. Ask red-faced Boston College and Syracuse, which were headed for the Big East exit, too, before ACC infighting caused their invitations to be revoked.

And the ACC's spin-doctoring fell flat. Despite its dogged dissembling, this endless soap opera was all about the money: Just one more appearance by an ACC school in the Bowl Championship Series, the quasi-national championship for college pigskin, could be worth close to $5 million to the conference. And when the BCS TV contracts are up for renewal in 2006, the ACC's share may rise by several million more.

But can you blame schools for scrambling for financial daylight? For following the money when they need it so badly?

Men's football—and to a lesser degree basketball—are the economic engines that drive college athletics. Most big-time sports departments depend on ticket receipts and TV contracts to pay the bills, without the assistance that subsidizes the debate club or any other college activities. And, of course, big-time sports attract alumni donations.

With so much riding on income generated by so few teams, schools are forever alert to turning first downs into a pounding drive for profits. The answer can be a stadium renovation that adds 20,000 cash-producing seats—or a football power like the Miami Hurricanes grabbing at a better offer. Miami President Donna E. Shalala, who on June 30 ditched the Big East for the ACC and fired a shot heard round the college world, had little choice. Should Shalala, former Health & Human Services Secretary, have turned down the chance for upwards of several million a year?

For making the future of the Big East so uncertain, the ACC may have more explaining to do. But one way to show that this unseemly spectacle wasn't entirely about bulking up overfed football and basketball programs would be to plow some of the new money into lesser sports.

Wrestling, track and field, and other "nonrevenue" sports have been under fire for a decade. Since 2000, 30 major universities have eliminated more than 60 men's and women's sports teams, according to *The Chronicle of Higher Education*. Countless other schools have trimmed athletic scholarships and frozen coaches' pay.

It's not just under-capitalized schools that are putting the squeeze on minor sports programs. In the past two years, the University of Kansas (men's swimming and tennis), Tulane (men's track), and Dartmouth (men's and women's swimming) all have taken the hatchet to lesser teams.

Even at Miami, the sun and surf capital of higher ed, the men's swim team took its last lap this spring. Maybe it could be revived with the extra cash the school is sure to see. million bucks buys a lot of pool time

Hyman is a contributing edit

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TENNIS

A VOLLEY OF THREATS

Why the men's tennis tour is a hotbed of discontent

The traveling circus known as pro tennis arrived on the outskirts of London on June 23. Yes, Wimbledon is in full swing. But this year, booming serves and deft volleys hardly seem to be center court, especially for the men. Boycott threats, lawsuits, pleas for more prize money, and a breakaway player group are stealing the headlines. Douglas Robson, who last wrote about the women's tour for BusinessWeek, *explains what's behind all the turbulence:*

What the heck are the players so unhappy about?

Money and control—but mostly money. The Association of Tennis Professionals (ATP), which runs the men's circuit, wants a bigger piece of the pie generated by the four Grand Slam tournaments—$50 million more, to be precise. The Slams operate independently of the ATP and kick in an average of about 11% of their income to players. Other events on the circuit contribute up to 39%.

Aren't tennis players a bunch of overpaid, overprivileged athletes as it is?

Well, yes and no. The 100th-ranked player last year (little-known Sargis Sargsian of Armenia) made $200,034 in prize money—not exactly chump change. But prize money at ATP events has decreased more than 6% over the past three years, to just over $55 million in 2003, while total prize money at the Australian Open, French Open, Wimbledon, and U.S. Open grew by 25%.

Is men's tennis in trouble?

It's certainly under duress. Tennis still lacks a comprehensive U.S. television package. Sponsorship dollars are scarce because of corporate belt-tightening. And there's growing player dissatisfaction with ATP leadership. Current CEO Mark Miles oversaw the $1.2 billion TV and marketing-rights deal in 1999 with Swiss sports marketing company ISL during the height of the economic bubble. ... overextended ISL went bankrupt t... years later, forcing the ATP to scram... for new sponsorship. The deal's imp... sion created a financial crater that eli... nated the players' multimillion-dol... bonus pool and forced the ATP to div...

HEWITT LOSING
He's a leader of the rebels

3% of prize money ... fund the players' p... sion plan—money t... would have gone i... their pockets.

Why don't the Slams share more of th... revenues?

The major tourneys are nonpro... and argue that their mission is to n... ture tennis, not throw dollars at sta... That means pumping millions eve... year into promotion, education, and ... cilities. The United States Tennis As... which owns the U.S. Open, says it ... tually lost money the past three yea...

The ATP says it has 80 players willing ... to boycott the Slams if they don't serv... up more money. Would players really ... do that?

Not likely. When a guy like Mar... Verkerk, a finalist at this year's Fre... Open, can make more in one tour... ment than he has made in five ye... on tour, there's little motivation to bl... off the majors. And is any player go... to forgo a shot at the $1 million sing... prize offered by this year's U.S. Op... What's more, history has shown spo... fans have little sympathy for strik... millionaire jocks. When asked whet... he'd support a boycott, Lleyton Hew... the 2002 Wimbledon champion, t... *BusinessWeek* through his agent: "No... chance." Of course, Hewitt is suing ... ATP over a $20,000 fine, and he may ... especially grumpy because of his fi... round loss at Wimbledon this year.

Why is the ATP sounding off just now?

Some insiders say the attack on ... Slams is CEO Miles's attempt to s... his roughly $1 million-a-year job. A... the money woes have everyone ... gruntled. In fact, earlier this year, ... dozen or so—including Hewitt—form... a rebel group called the Internatio... Men's Tennis Assn. (IMTA) and thre... ened to organize a new men's associat... if Miles doesn't show them the mon...

So what's going to happen?

The Slams have rejected the ATP's ... million demand, but negotiations con... ue and players keep playing. Many h... that tennis will be forced to streaml... its convoluted structure. But for n... the game is stuck at deuce.

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BONDS

MUNIS: WHAT'S A FAIR PRICE?

Critics say markups are too high. Now regulators are paying attention

When Mary H. Day's broker moved from Olde Discount Brokerage to PaineWebber in 1997, he persuaded the Vienna (Va.) artist to transfer her $2 million municipal-bond portfolio, too. He reasoned that with PaineWebber's strength as a muni underwriter, he could get her better deals than at Olde Discount. The broker returned to Olde Discount a year later, but PaineWebber officials persuaded Day to stick with them. "I was told that because of the size of my account, I was not only going to get the best price but even discounts," says Day, a dedicated muni investor.

By late 2000, Day's relationship with PaineWebber was over. She closed her account in frustration over the poor performance of her portfolio. She says that after comparing her trades with those at other firms the same day, she concluded that markups by PaineWebber were as high as 5%. A *BusinessWeek* check of a sample of her trades against indicated prices from Bloomberg Financial Markets showed similar discrepancies. Day alleges that the markups cost her more than $180,000. "I feel that I've been unfairly gouged," says Day, who is seeking about $1.1 million in damages through arbitration from PaineWebber, which is now part of UBS Financial Services Inc. UBS spokesman Paul Marrone said Day got "good execution, fair and reasonable prices." After examining the trades, the firm concluded that her claim was "without merit," he added.

The dispute highlights a big problem in the trading of municipal bonds, which are an increasingly popular vehicle for investors seeking an alternative to the low yields on Treasuries. Critics say the market is notorious for wide spreads, or the difference between what brokers pay sellers and charge buyers of the same bond. Regulators have succeeded in squeezing spreads in sales of stocks down to just a few pennies—to the point where Wall Street dealers complain they aren't making money. But regulators are only now starting to look at a $9.5 billion-a-day muni market in which spreads of 5¢, 10¢, and 20¢ on the dollar aren't uncommon.

Although the muni market is far less liquid than the stock market, many institutional investors contend that spreads still shouldn't exceed 1% to 2% for most issues, or $1,000 to $2,000 on a muni sold for $100,000. Yet, resale prices for munis "are probably worse than the secondary market for vacation time shares," contends Kevin Olson, a former muni trader for Bank of America and PaineWebber who now publishes a daily report exposing the muni transactions with the worst spreads on his Web site, MunicipalBonds.com.

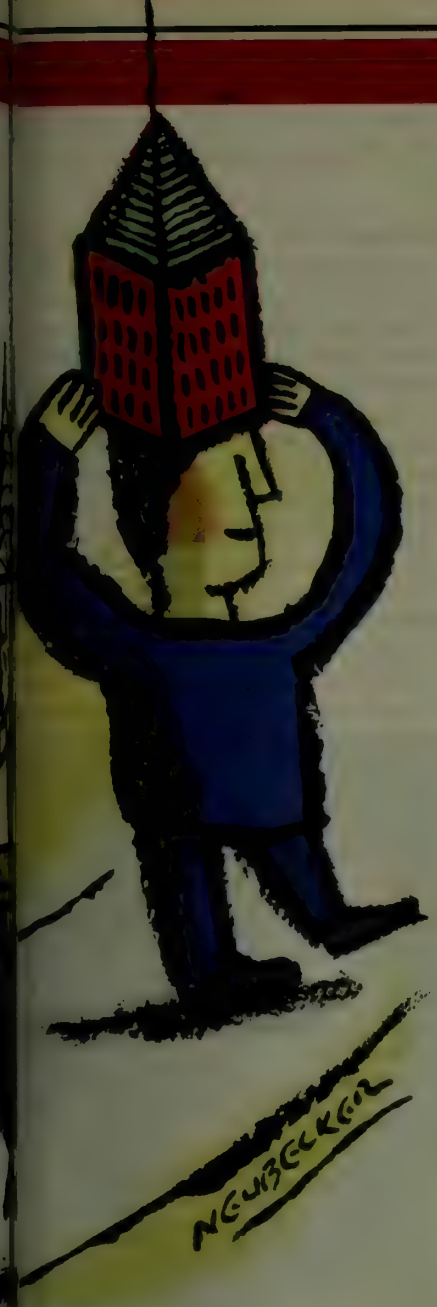
Muni dealers say the problems are vastly overstated. They insist that trades with excessive spreads are no more than a small fraction of the 29,000 daily muni transactions. Besides, they say, it isn't fair to compare the trading costs for munis and stocks, since there's no New York Stock Exchange for munis. Instead, there's a fragmented market comprising some 50,000 government

issuers with 2 million different bo bought and sold by hundreds of dea across the country.

With many older or more obsc munis trading only sporadically, dea and even some regulators say it's r sonable to expect investors to tak haircut on bonds that dealers kr

HAVE WE GOT A DEAL FOR YOU

Spreads in the municipal market can be enormous. Here are examples this y of dealers buying a bond a customer and then reselling it later the same at a much higher price



y'll have a hard time reselling. "What
fair and reasonable price for [a]
w York City [issue] may not be the
e for the Opelika [Ala.] schools—
y're not comparable bonds," says
ristopher Taylor, executive director
he Municipal Securities Rulemaking
rd, the self-regulatory organization
in Washington that oversees the muni-bond market.

Critics charge that the problems extend well beyond that. Olson studied 644,000 "markets," each a day's trading in an individual muni issue, last year. In one-quarter, or 162,000, of them, either the spreads were larger than 1%, or the purchase or resale prices fluctuated by more than 4%. That occurred in 99,000 cases in 2001, and 86,000 in 2000.

Some money managers think the situation is getting worse. They say brokers, trying to make up lost income from stock trading, may be exploiting the low yields on taxable Treasury bonds to sneak through higher charges on munis, which are exempt from most income taxes. "When you factor in the tax exemption, munis look cheap compared with Treasuries no matter how much the brokers mark them up," says Ken Woods, an Atlanta money manager who handles $500 million in mostly municipal bonds for private clients.

The problems are overstated, say dealers, and apply to a fraction of the 29,000 daily transactions

The trouble might not end there. Many munis have a call feature allowing the issuing state or municipality to pay off the bonds early, often at par, on preset dates. Critics say these are potentially expensive traps for the unwary. The risk is that when buyers pay more than par for callable bonds, the interest they receive won't cover the premium if the bond is called, leaving them out of pocket.

Consider recent trading in bonds issued by the city of Saginaw, Mich., for a local hospital, St. Luke's. The bonds were first sold in 1991 with an interest rate of 6%—a rate that's hard to find now—and a maturity of 2021. On June 20, two bonds with a face value of $15,000 were sold, one at $100.25 and the other at $102.25 per $100. But the next par call on these hospital bonds was looming little more than a month away, on July 28—meaning that if the hospital chooses to refinance these bonds, the buyers will lose money.

This situation appears to be getting worse, though dealers dispute that. Olson says his analysis of 2002 trading data filed by dealers to the muni board shows that in 1,681 trades, muni bonds were sold to investors at prices that saddled them with a risk of losses—more than double the 779 such trades in 2001. But dealers say many of these transactions reflect calculated gambles by savvy investors who, in their scramble for higher returns, are betting that the issuer won't call the bonds early. If they guess right, they can earn a much better return than they would otherwise have received on a bond that wasn't about to be called.

Still, the growing worries about how the market works appear to be prodding the muni board into action. On June 13, it said it will clarify rules to ensure "fair pricing"—but without placing limits on markups, such as the 5% cap that the NASDAQ puts on stock trades. And on June 24, the board began disclosing trades in less-active muni bonds on the following day; previously the information was available only after a week. Taylor says the board is on track to begin real-time reporting of all muni trades by mid-2004, as part of a deal the industry struck with the Securities & Exchange Commission back in 1994.

Such reforms will ripple though the market. Wall Street firms warn that liquidity could dry up in more obscure bonds, but money managers admit that real-time trade disclosures could reduce the opportunities for shrewd traders to make easy money by exploiting price disparities. "I shouldn't be interested in price disclosure because I'm able to buy at good prices," says Thomas J. Fetter, vice-president of municipal investments for Eaton Vance Management, a Boston funds firm. "But price transparency is going to make this market far more efficient. This will be good for everyone." Particularly for the legions of investors who now can only guess whether they're getting a good deal.

By Dean Foust in Atlanta

NTEREST RATE / MATURITY	DATE	BOUGHT*	SOLD*
ounty (Md.) Pollution Control 2014	Jan. 9	$60	$100
Mass.) Water & Sewer of 2009	Feb. 3	100	129
co Highway & Transportation Auth. 35	Apr. 11**	109	109 to 153
Health Facilities Authority 2018	June 26**	50	53 to 77

00 of face value rounded to nearest dollar
**More than one purchase or sale that day
albonds.com, Bond Market Assn.

INVESTING

THE HUBBUB OVER 'SOFT DOLLARS'

Why the SEC is looking at fund managers' payments to brokers

Campaign-finance laws have banned the use of "soft-money" donations in political elections—but an equally slippery form of currency continues to circulate on Wall Street. Under so-called soft-dollar arrangements, money managers overpay on commissions to their brokers, who then use the excess to provide the managers with everything from research reports to Bloomberg terminals. Critics have railed against these thinly disguised kickbacks for decades, and now Congress and the Securities & Exchange Commission are taking a hard look.

The SEC is considering limits on what money managers may buy with soft dollars. A bill sponsored by House Capital Markets Subcomittee Chairman Richard H. Baker (R-La.) would force mutual-fund managers to disclose more about their use of soft dollars and direct the SEC to consider banning the practice.

Here's how soft dollars work, and why many experts think they create conflicts of interest that cost investors billions:

What are soft dollars?

Soft dollars are created when investment managers who buy or sell stocks for a pension, insurance, or mutual fund pay more than the lowest available brokerage commission. Most of them do: Financial experts say that fund managers pay their brokers an average of 5¢ a share in commissions, of which no more than 2¢ represents the actual cost of trading. The managers are supposed to use the excess, the soft dollars, to buy research that the brokers supply from their firm's analysts or from independent shops. Managers can also use soft dollar credits to obtain data feeds, news services, and financial information terminals.

Why do mutual funds overpay so much?

Because of how they report their expenses. Brokerage commissions are subtracted from fund returns, and remain largely invisible to investors. If managers bought their own research, they would have to recover the cost by jacking up their reported fees. Investors compare fees when they're shopping for funds, so hiding the cost of research and other services makes funds look cheaper.

How much money are we talking about?

A lot. A 1998 SEC survey of 280 investment advisers and 75 brokers found that for every $1.70 in commissions paid to a broker, advisers received $1 worth of soft-dollar products and services. By some estimates, soft dollars accounted for nearly three-quarters of the $8.4 billion in total U.S. equity commissions paid 2002.

This sounds like a kickback. Is it lega

Soft dollars are an outgrowth of SEC's ban on fixed commissions in 19 Before then, research came free as p of the deal. But after the ban, inve ment advisers feared they could be h in breach of their fiduciary duty if t paid more than rock-bottom commissi So the SEC created a "safe harbor" to advisers pay more if they got researc return. Advisers still have to make s that what they pay is reasonable.

What's the rationale for soft dollars?

Proponents say that investors ben because soft dollars give advisers acc to extensive research that can enhan

Money earmarked for research has been spent on unrelated expenses such as cable TV, travel expenses, postage, and even parking fees

fund's performance. "Investors are ting an enormous bargain," says Le Pickard, a lawyer at Pickard & Di LLP in Washington who represents kers and mutual funds. Others ar

soft dollars support independent re-ch shops that otherwise would have ble competing against big investment ks such as Goldman, Sachs & Co. Morgan Stanley.

what's the problem?

'und managers have an incentive to pay, increasing investors' costs. "Ad-rs might choose broker-dealers on basis of soft-dollar products and vices, not trade execution quality," General Accounting Office noted in a e report. Also, managers might over-le to generate soft dollars. "It's an rent conflict of interest," says ex-asury Dept. official Gary Gensler. ecause soft dollars are largely hid-from investors and lightly regulated, 're easily abused. In a June 9 re-, Paul F. Roye, director of the SEC's estment Management Div., said a ber of hedge-fund advisers "often soft dollars to pay for services that clearly outside the safe harbor, in-ing payment for office operations." SEC's 1998 study found that 35% rokers paid for items that had noth-to do with research—such as cable travel expenses, postage, and even ing fees—with soft dollars.

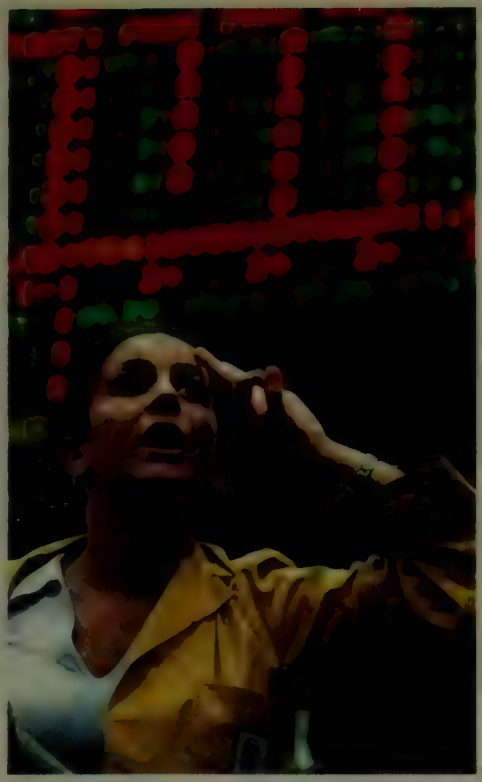
uld soft dollars be banned?

anguard Group founder John C. le and other investor advocates say But Congress is in no hurry to inate a freebie that money man-s hold dear. While House Capital kets Subcomittee Chairman Richard Baker (R-La.) has introduced a bill urb soft dollars, even he stops short ban: His bill would give the SEC 18 ths to study outlawing soft dollars. olitical reality aside, a ban could de-se competition. Eliminating soft dol-would squeeze many independent arch firms at a time when conflicts nterest between analysts and their stment banking brethren have put a mium on untainted research.

there other ways to clean up soft-ar practices?

he SEC is considering banning their to pay for data terminals and other head. Greater disclosure would help, "Investors should be able to know t their soft dollars are being spent and whether they're being spent in r interest," says Scott C. Cleland, of Precursor Group, an independent archer that derives its revenue from dollars. Baker's bill would require ual-fund advisers to detail soft-dollar chases in an annual report to fund ctors. A spotlight on costs could de-managers from spending more than need to for investors' sake.

By Amy Borrus in Washington



PERKING MERC: *The dollar's fall and round-the-clock trading lifted volume*

MARKETS

BACK TO THE FUTURES

Chicago's currency market, left for dead, is thriving again

Back in 1999, it looked as if the days of currency-futures trading at the Chicago Mercantile Exchange were numbered. The advent of the euro wiped out 12 currencies at a stroke, and volume at the Merc plummeted by a third from 1998 to 2000. "I left in 2000 because currency trading seemed to be dying a slow death," says Jay A. Deutsch, a currency trader who started trading NASDAQ futures instead.

Well, since January, Deutsch has been back in the currency pits. Volume at the Merc, the world's biggest currency-futures market, was up 35% over the first five months of the year vs. the same period last year. In March, 3.4 million contracts changed hands, the biggest month since trading began 31 years ago. At that lick, volume will top 30 million contracts this year, up from just 19.3 million in 2000.

What's fueling the frenzy? A combination of the dollar's rapid decline and the introduction of round-the-clock electronic trading for currency futures in April, 2001. With orders no longer needing to be called in from Singapore or Frankfurt, the pool of potential investors expanded dramatically. And spreads—the difference between what traders pay for contracts and what they sell them for—narrowed considerably, making the market more efficient. "Earlier, there were times when there would be offers and no bids," says Steven A. Greenberg, chief executive of online futures trader Alaron Trading Corp. in Chicago. "But now, markets are tight, and you can always get the price you want." Already, 42% of currency futures are traded electronically, and if that share keeps rising, the Merc may close the pits. Even now, many traders make electronic trades on handheld devices when they're in the pits.

The three-year bear market in stocks sent many players scrambling back to currency futures. "The 2% extra return that mutual funds and hedge funds can get on them is more important today than it was when they made 20%-plus returns on equities," says Richard E. Sears, a managing director at the Merc. In fact, just in the first four months of the year, seven new currency-futures funds were launched, bringing the total to 44, according to hedge-fund newsletter *MAR/Hedge*.

The action in Chicago isn't mirrored elsewhere. The much larger interbank market in foreign-exchange options, forward contracts, and swaps has declined 7.5% over the last two years following the merger of several large banks.

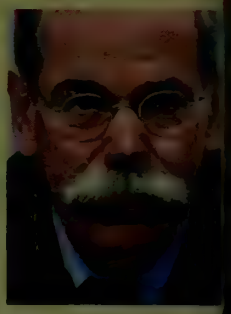
Will forex futures keep booming? Probably, provided currencies remain volatile and investors don't drift away if stock markets recover. But success invites competition. Two European rivals, the London International Financial Futures & Options Exchange, which has a small exchange in New York, and the Frankfurt-based Eurex, which plans to launch a U.S. exchange early next year, may offer currency-futures contracts. Neither would comment. They could rain on the Merc's party.

By Pallavi Gogoi in Chicago

FOREX BOOM

Currency-futures trading slumped after the euro was introduced, but rebounded with electronic trading

Data: Chicago Mercantile Exchange, *BusinessWeek*



HIGH HOPES Zetsche (above) is betting that new Chryslers will be hot enough to stave off plant closings

COMMENTARY

By David Welch and Christine Tierney

CHRYSLER'S SCARY LEAP OF FAITH

If any employer is in a position to ask for concessions from the United Auto Workers this summer, it's Chrysler. Not only does DaimlerChrysler's U.S. auto maker expect to lose $1.2 billion in the second quarter, but its plants are the least productive. Given its lackluster sales, the company has up to 17,000 more workers than it needs—nearly a fifth of its hourly workforce.

But so far, management isn't planning to ask for any big restructuring as part of its bargaining for a new labor contract. Instead, Chrysler Chief Executive Dieter Zetsche is betting that a slew of new cars in the pipeline will be so hot that demand, not job cuts, will bring back profits. Indeed, so far only Ford Motor Co. has signaled that it wants plant closings, says UAW President Ronald A. Gettelfinger.

Passing up the opportunity to permanently lower costs in the upcoming labor talks could be a mistake. Zetsche's risky labor strategy flows out of a larger game plan that's looking increasingly dubious. His decision to hold on to excess capacity is based on the assumption that Chrysler can pump up its U.S. sales by as much as a fifth. That would add some 500,000 new vehicles a year to Chrysler's current 2.7 million annual sales in North America.

Problem is, such ambitious goals no longer look feasible without a major turnaround in the U.S. car market. After the surprise second-quarter loss, analysts now say Chrysler could lose up to $1 billion this year. Already, its U.S. sales are down 4% through June. "I don't know where they're going to get that much growth," says Rebecca Lindland, senior analyst at Global Insight Inc. in Boston, which expects Chrysler to sell just 65,000 more vehicles a year by 2008.

If Zetsche sticks to his plans anyway, he could be setting the company up for a long stretch of excess capacity. It's not clear that his bosses in Germany will go along with that approach. Under mounting pressure from investors, the DaimlerChrysler board was due to take a hard look at Chrysler's struggle at a meeting on July 2-3 in Auburn Hills, Mich. The directors may conclude that Chrysler needs to undergo a major restructuring, perhaps as extensive as the $4 billion one Zetsche imposed in 2001. It may need to shutter factories or even dispense altogether with some of its poorly selling small cars so it can focus on Dodge's successful truck line. So far, though, Zetsche stands by his sales goals, although the company declined to be quoted on its labor strategy.

The auto maker's problem is clear when you look at some of its plants that don't have enough to do. Its Belvidere (Ill.) factory, which cranks out the slow-selling Dodge Neon, is running at less than half its capacity, as is a Jeep Wrangler plant in Toledo. Overall, Chrysler has the same level of excess workers as Ford, about 20% of payroll. But its rival intends to ask the UAW for permission to close factories. If Chrysler won the right to consolidate assembly, it could cut low-capacity units, too.

What's more, Chrysler's labor surplus comes on top of its lagging productivity (chart). If management moves to raise efficiency and doesn't sell more cars, it will end up with even more unneeded workers.

Zetsche does intend to demand some concessions in the new labor pact that will replace the one expiring on Sept. 14. His main goal: to get the UAW's blessing to sell five parts

PRODUCTIVITY PROBLEM

LABOR HOURS PER VEHICLE

Chrysler	40.6
Ford	39.7
GM	36.7

Data: Harbour & Associates

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plants targeted in the 2001 restructuring. Chrysler still pays union workers $22 an hour to make parts they could buy more cheaply. Its deal with the UAW could mirror a recent pact to sell its New Castle (Ind.) parts plant to supplier Metaldyne Corp., which allowed the UAW into the factory but only at its lower wage rates of about $16 an hour.

This strategy will help to slice Chrysler's bloated parts cost but does little to reduce its workforce. Instead, the auto maker will need to rely mostly on attrition if sales don't materialize. Chrysler loses 2,000 workers a year through retirement, so a three-year labor deal without the flexibility to close plants could leave up to 11,000 extra workers.

How realistic is Zetsche's goal of selling an extra half-million vehicles a year? It's more than Toyota has drummed up since 1998, when a booming economy and new sport-utility vehicles lifted the Japanese auto maker's annual U.S. sales by 400,000 vehicles. If Chrysler's sales gains come in a lot lower, it could be forced to rely on continued incentives—currently $4,000 a vehicle—to move the metal. Coupled with low productivity, that would further squeeze earnings. What's more, "the dollars they're spending on incentives delay the product offensive," says Michael Robinet, vice-president of CSM Forecasting Inc.

So far, though Chrysler hasn't slowed its new product plans. It recently launched an attractive crossover minivan, the Pacifica, and was due to follow on July 4 with the sporty Crossfire two-seater. Next year, the company will roll out nine new and replacement models, including a sleek, rear-wheel-drive sedan.

If Americans snap up all the new cars, the company will need all its workers. But if Zetsche is overreaching, Chrysler could pay a steep price. "If the cars don't sell, they'll have to close plants," says Sean McAlinden, labor economist at the Center for Automotive Research in Ann Arbor. That would mean today's labor strategy will have just delayed an inevitable restructuring—dragging Chrysler down in the process.

Welch and Tierney cover the auto industry from Detroit.

ILLUSTRATION BY JOHN UELAND

COMMENTARY

By Louis Lavelle

STOCK OPTIONS: THE FUZZY NEW MATH

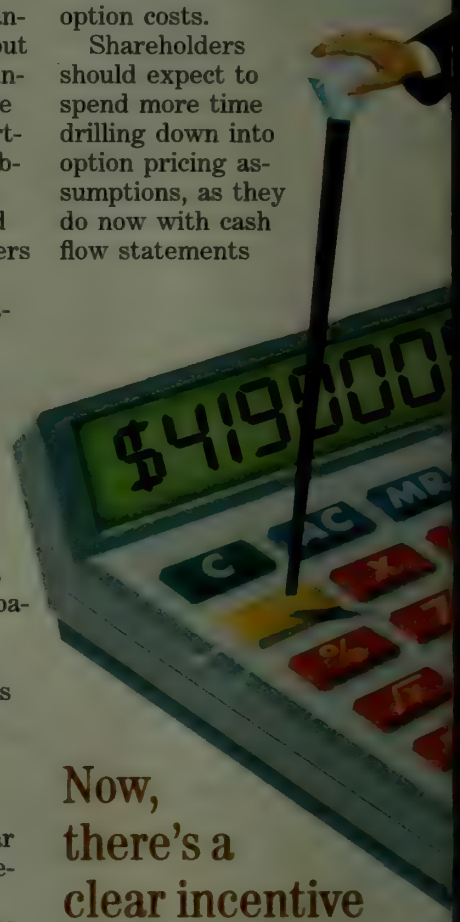
Shareholders rarely get a glimpse of the future. Yet in the past few months, they've been given a peek at what they may be in for if companies are required to include the cost of employee stock options on their financial statements, which now seems all but certain. It's not pretty. If 2002 is any indication, options will likely have a huge impact on profits, slicing 20% off reported earnings. Worse, in solving one problem by forcing companies to recognize that options have a cost, we've created something equally complex: Shareholders will have no way of knowing whether their companies are accurately estimating expenses or engaging in wishful thinking to burnish the bottom line.

The source of the problem, as any expensing opponent will tell you, is the Black-Scholes option pricing formula, the most widely used method for estimating option expenses disclosed in the footnotes of annual reports. Four of the six variables it uses to calculate option values require companies to peer as much as 10 years into the future. Trouble is, there's no accurate way to determine when employees will exercise their options, how wildly the stock price will fluctuate, or what will be the stock's dividend yield and risk-free rate of return on U.S. Treasury notes. What's more, there's a clear incentive to goose these numbers, especially among tech companies that are heavy issuers of employee stock options.

Even modest reductions in the assumed stock volatility and the life of an option—or small increases in dividend yield and the risk-free interest rate—can cut option expenses significantly. If the company is expensing, that boosts net income over several years as the full cost of option grants is recognized. Adjustments occur every year, as they should, to account for changing historical trends and option plans. The trick for investors is determining which are warranted.

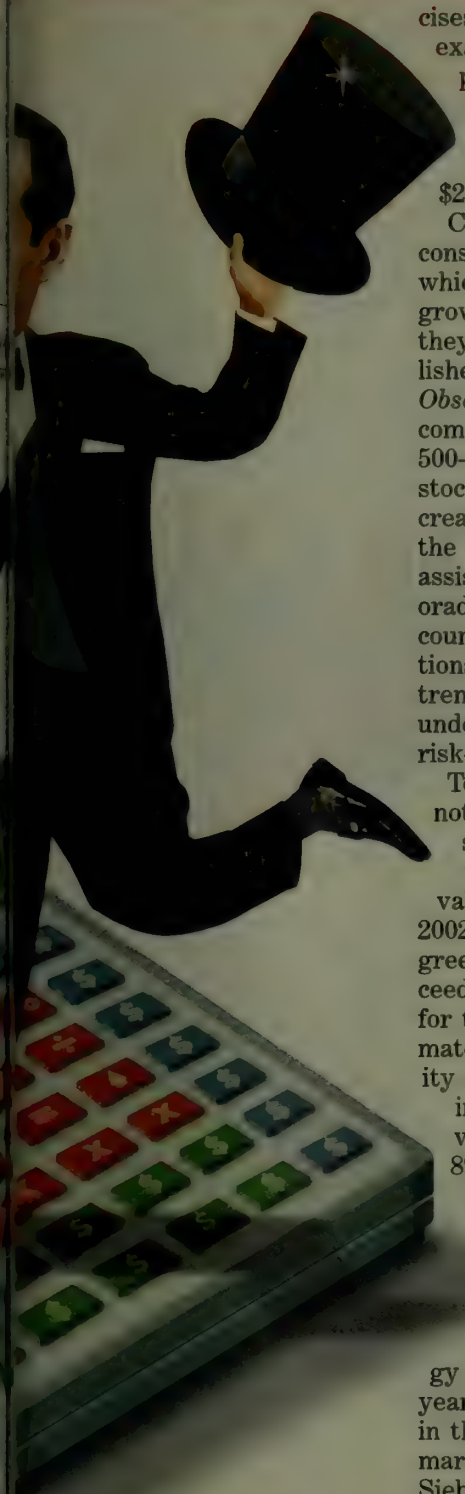
As expensing becomes a reality and options become a cost to be managed like overhead or payroll, finance chiefs will likely find legitimate ways to reduce that expense. Faster vesting periods, for example, would justify shorter o lives, while boosting dividends w legitimately allow for a higher dividend yield assumption—either of which would reduce option costs.

Shareholders should expect to spend more time drilling down into option pricing assumptions, as they do now with cash flow statements



Now, there's a clear incentive for companies to goose the numbers

and the like. But there are thing regulators and auditors can do t it easier—and restore the trust critical to the success of option ing. For starters, the Financial ing Standards Board needs to in the transparency surrounding op ues, requiring companies that de significantly from actual historic to explain why. The Securities & change Commission needs to cra on finance executives who game tem. And auditors who value th



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cises. Capital One Financial Corp., for example, reduced its option life expectancy in 2002 to 5 years, from 8.5 years, after granting options with shorter vesting periods. That change cut option costs by $29.3 million.

Current rules give finance chiefs considerable leeway in determining which assumptions to use, and a growing body of evidence suggests they're using it. Jack T. Ciesielski, publisher of the *The Analyst's Accounting Observer*, found that one out of five companies in the Standard & Poor's 500-stock index reduced option life, stock volatility, or both, in 2002, increasing actual or pro forma earnings in the process. Derek Johnston-Wilson, an assistant accounting professor at Colorado State University, compared accounting assumptions used to value options in 2002 with actual historical trends and found that many companies underestimated both volatility and the risk-free interest rate.

To get a sense of how these little-noticed changes can affect profits, consider how Siebel Systems Inc. dealt with volatility when calculating the value of 5.7 million options awarded in 2002. Siebel assumed volatility—the degree to which stock price changes exceed their historical average—of 65% for the life of the options, which it estimated at 3.4 years. At the time, volatility for the previous 3.4 years was inching past 100%. By reducing its volatility assumption to 65%, from 89% in 2001, the company trimmed $15.5 million from its option cost, a savings that is spread over several years. Siebel says its decision was based on lengthy analysis, including a survey of rival technology outfits. "The past five years was the biggest anomaly in the history of the equity markets," says Paul Gifford, Siebel's vice-president for finance. "To say that that history predicts the future without applying some sanity to it is absurd."

Other examples abound. Broadcom Corp. reduced its volatility assumption to 70% last year, from 90% in 2001. Actual volatility at the time was nearing 112%. That trimmed $74 million from its option expense. The company concluded that volatility in the post-bubble years was likely to decline as the company became larger, more diversified, and more profitable. At Hilton Hotels Corp., management predicted that its options would be exercised faster—a notion that compensation experts say seems unlikely with the stock down 23% from its post-September 11, 2001, high. And with five-year volatility at 43% and rising, Hilton predicted that volatility would decrease to 34%. Hilton maintains that the assumptions are based on empirical fact, and declined to elaborate. But Patrick S. McGurn, senior vice-president at proxy adviser Institutional Shareholder Services, says Hilton shows that "rosy scenarios are alive and living in Corporate America."

It's unclear why so many companies shifted their assumptions sharply downward last year. One possibility is that they're taking advantage of the lull before expensing takes hold. In the post-expensing world, such changes will be scrutinized closely for signs of tinkering. By making changes now, finance chiefs can lock in the more favorable assumptions for 2002 grants and lay the groundwork to justify low assumptions for future grants.

It should come as no surprise that companies are aggressively managing option values as the prospect of expensing becomes real. But that's no reason to abandon expensing. Regulators need to devise a way to value options that doesn't give companies an opportunity to engage in self-serving guesswork. Without that, the calculation will distort the real cost of stock options—exactly the problem expensing was meant to solve.

Lavelle covers management from New York.

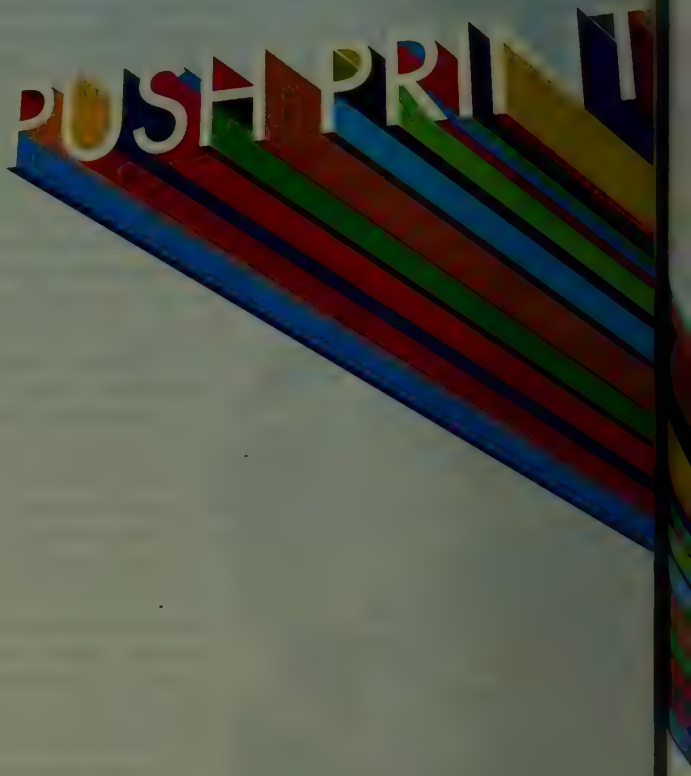
Adjusting the Formula

By changing a single number in its options-pricing formula, Siebel Systems cut the cost of its 2002 options by 22%:

ASSUMPTIONS	IF VOLATILITY ESTIMATE DID NOT CHANGE	AS REPORTED WITH CHANGE
OPTION LIFE	3.4 years	3.4 years
VOLATILITY	89%	65%
RISK-FREE RATE	1.99%	1.99%
STOCK PRICE	$20.62	$20.62
EXERCISE PRICE	$20.62	$20.62
DIVIDEND YIELD	0	0
BLACK-SCHOLES VALUE	$12.41	$9.68
OPTIONS GRANTED	x 5.7 million	x 5.7 million
OPTIONS EXPENSE	$70.7 million	$55.2 million

Data: Company filings

When you're ready to be heard,



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AFRICAN AMERICANS

PROGRESS WITHOUT PARITY

Fewer are poor, but blacks are no closer to economic equality

Raised outside Philadelphia on social security after his father's death, Joseph McKenna became the first in his family to earn a college degree. After graduating, he worked as a black professional at predominantly white Wall Street firms. But now, at 37, McKenna has begun to wonder about his future. Last September, investment bank J.P. Morgan Chase & Co. axed him from his $85,000-a-year job as a credit-card analyst amid a string of layoffs. Now he scrapes by on $400 a week in unemployment as he looks for a job, relying mostly on money from his wife, Cherrie, who still works in financial services. "It's hard to keep cheery all the time," he says. "I just want to get back into the workforce."

Millions of African Americans, like McKenna, achieved middle-class prosperity during the 1990s boom. The supercharged labor market drove black unemployment rates down to a very low 7% in early 2002. Employers, strapped for workers, took chances on people whom they would otherwise not have hired. The racial problem in America seemed ready to yield to the inexorable forces of economics.

But the gains for blacks turned out to be more fragile than anyone realized. Since the stock market bubble burst in March, 2000, black unemployment has soared to nearly 11%, double that of whites. And it's not just less skilled blacks who got hurt. In 2002, the number of employed black managers and professionals fell, with much of the decline coming in financial services, where McKenna used to work. Meanwhile, the number of employed white managers and professionals continued to rise, including in financial services. "Blacks have been disproportionately hit," says Harvard Business School professor David Thomas.

Taking the last 10 years as a whole, the data reveal a surprising—and distressing—fact: Despite the biggest economic boom in 30 years, black Americans closed little, if any, of the gap with whites on important measures of economic success. Average black household income gained slightly, going from 63.4% of white household income in 1991 to 64.9% in 2001, the last year available. Black men earned 73.9% of what white men earned in 2002, measured by median full-time wages and salaries. That's barely up from 73.4% a decade ago. Black female earnings actually lost a bit of ground over the same peri compared with those of white wome

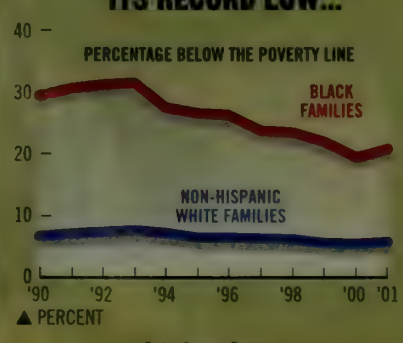
The same lack of relative progr shows up in other measures. When comes to wealth accumulation, bla failed to catch up with whites in buoyant 1990s. For most middle-cl families, their home is their major set—but the black-white gap in hon ownership rates narrowed by less th a percentage point since 1994.

More broadly, in 2001, the avera

PHOTOGRAPH BY ROB KINMONTH, CHART BY LAUREL DAUNIS ALLEN/BW

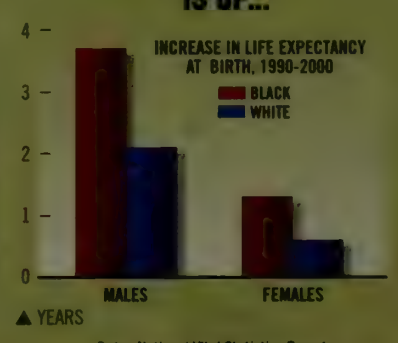
BIG GAINS FOR BLACKS:

BLACK POVERTY IS NEAR ITS RECORD LOW...



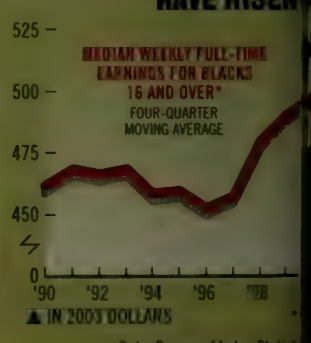
Data: Census Bureau

...LIFE EXPECTANCY IS UP...



Data: *National Vital Statistics Reports*

...AND WAGES HAVE RISEN



Data: Bureau of Labor Statist

ANALYST INTERRUPTED

Joseph McKenna was laid off by J.P. Morgan Chase last fall. For now, his wife, Cherrie, supports them both

worth of black families was only 16% n-Hispanic white families' average worth—down from 22% in 1992. That ts a big jump in the number of hy white families. By 2001, a stun- 18.2% of white families had a net over $500,000, compared with only of black households.

nd in higher education—often be- l to be a bright spot for African ricans—the gap didn't close at all. hare of whites with a college degree grew by 5.1 percentage points from 1992 to 2002 while the black share rose by the same amount. This lack of progress portrays a different vision of the future than Supreme Court Justice Sandra Day O'Connor's declaration, in the recent affirmative-action decision, that "we expect that 25 years from now, the use of racial preferences will no longer be necessary."

The persistence of the black-white differences in economic performance is especially troubling given that another long-standing divide—the income disparities between men and women—has been shrinking. In 1992, women over 25 earned 74% of what men over 25 earned, measured by full-time median earnings. By 2002, they were earning 78% of what men made.

Some argue that the race gap gets too much attention. As long as blacks are getting steadily better educated, better paid, better housed, and wealthier, why should anyone care that whites are making gains at about the same rates?

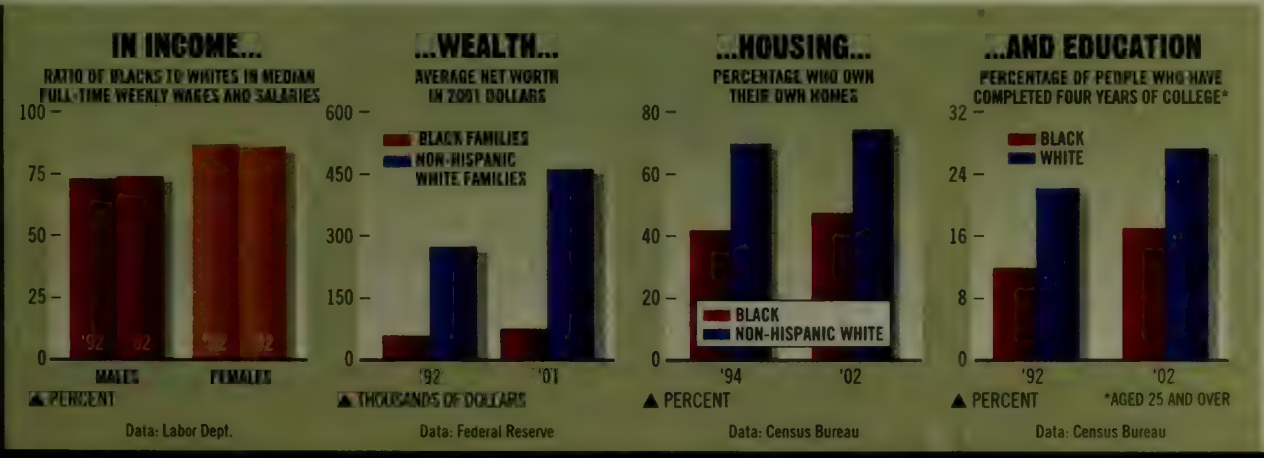
There's no doubt that when measured on an absolute scale, rather than on one relative to whites, the improvement in the economic situation for blacks has been impressive. The share of blacks in families living below the poverty line plummeted from 31% in 1992 to 21% in 2001, the latest year available. Before this drop, the black family poverty rate had bounced between 27% and 34% since the 1960s.

Equally important, the share of blacks 25 and over with four years of college jumped to 17% in 2002, from just under 12% in 1992. That's a much bigger rise than in the previous 10 years. The implication: With more work experience and better education, blacks may be better positioned to take advantage of the next big upturn in the economy, breaking the cycle of poverty.

Moreover, the surge of immigration in the 1990s and the rapid growth of the Hispanic population have blurred the ethnic and racial makeup of the country. The 2000 Census offered Americans the choice of identifying themselves as belonging to more than one race. Also Hispanics, not blacks, are now the largest minority group.

Yet it still makes sense to pay special attention to the economic gap between whites and blacks. It's a fact of U.S. history that civil rights legislation was passed specifically to help African Americans. There's also a perception that the

HE GAP WHITES ARDLY WED:



lingering gap has something to do with a variety of social and economic factors that have inhibited many African Americans from achieving their full potential.

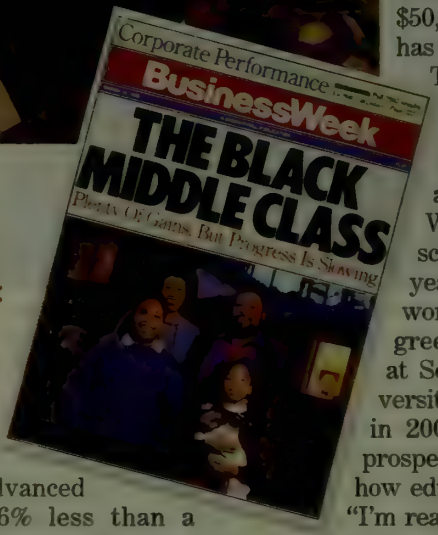
African Americans, after all, inherit the legacy of America's "peculiar institution"—slavery. Blacks, it's painful to recall, were counted as three-fifths of a person for census purposes in the Constitution. After the abolition of slavery came the infamous Jim Crow laws. In 1883, the Supreme Court ruled that the 14th Amendment did not protect blacks from discrimination by private businesses and individuals. "We are all under the gun together, because of history, to pay attention to this," says Rebecca M. Blank, dean of the Gerald R. Ford School of Public Policy at the University of Michigan.

It's tempting to conclude that racial discrimination has been relegated to history now that the Supreme Court has upheld affirmative action and black men run such powerful companies as AOL Time Warner, American Express, Merrill Lynch, and Fannie Mae.

But is it? Discrimination in hiring still exists, as evidenced by a recent study that tested employers' reactions to 5,000 résumés that were doctored to make the applicants appear either black or white. Holding all else equal, job applicants with white-sounding names like Emily and Neil were 50% more likely to get called for an initial interview than applicants with African American-sounding names like Lakisha and Tyrone, reports the study by Marianne Bertrand of the University of Chicago Graduate School of Business and Sendhil Mullainathan of Massachusetts Institute of Technology. Most disheartening: Having excellent credentials boosted callbacks for "black" résumés far less than it helped "white" résumés.

Black managers and executives are also getting paid less than whites in similar jobs. A new study, based on government data from 1999 to 2002, by William M. Rodgers III, associate professor of economics at the College of William & Mary, shows that black male executives and managers earn 23% less than white ones. Rodgers concludes that only about one-quarter of the gap is based on factors such as experience and education.

Indeed, black men lag behind in every major occupational category—from police officers to accountants. Those in protective-services jobs get paid 16% less than white men. Professionals make 19% less than their white counterparts. At the top end, these gaps are widening. According to government data, in 1992 the average black worker with an advanced degree earned 16% less than a white worker with advanced education. By 2001, the rift widened to 25%.



THEN AND NOW
Earvin, with his children Allyson and William, sees black gains eroding. Inset: On our cover in 1988. His wife has since passed away

When blacks' résumés get a colder reception than whites', it's not always because of active discrimination. It's often a subconscious decision—what Chicago's Bertrand calls a "rational reaction." That is, the legacy of lagging economic performance by blacks causes an employer to infer that a black applicant will be less productive. This creates a vicious cycle in which discrimination doesn't go away until after blacks have managed to succeed in spite of it.

Since blacks have a smaller cushion of wealth than whites do on average, extended unemployment takes a bigger toll. At some point, unemployed b lower their sights, notes Dr. Willia Spriggs, executive director of the tional Urban League. "They hav move down in the labor market, and shows up in lower pay."

Consider the plight of Judy E She lost her job as an manager in June, 2002. nearly a year of knockin doors, she accepted a con sion-only spot with cable Comcast Corp. in May. now rises before dawn commutes 30 miles from Chicago home to Ind where her job is to appr people who are tapping the cable-television servi neighbors and convert the paying customers. This t work makes her only a $180 per week.

The lost ground trou even blacks who are doing When Larry L. Earvin an family were featured in a *BusinessWeek* cover stor black America's rising m class, he was a college ad istrator making less $50,000 a year. Since 200 has been president of Hu Tillotson College, a his cally black institutio Austin, Tex., earning than $120,000. His chil are also thriving: His William, 25, teaches school in Atlanta. Earvin year-old daughter, Allys working on her master's gree in health administr at Southwest Texas State versity in Austin. (His wife in 2000.) But despite pers prosperity, Earvin sees first how educational gains are ero "I'm really anxious. The highe ucation participation rates ar blacks are not what they should be.

It's possible to disagree over whe the glass is half-full or half-empty black Americans. But there's no d that the racial disparities that have gered for decades weren't wiped ou the boom of the 1990s, and they a about to disappear anytime soon.

By Roger O. Crockett in Chic with Peter Coy in New York

BusinessWeek online

For a story on black female leadership and more, see www.businessweek.com/magazine/extra.

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COMMENTARY

By Roger O. Crockett

HOW TO NARROW THE GREAT DIVIDE

Over the last four decades, African Americans have benefited enormously from initiatives ranging from civil rights legislation to Head Start and the Job Corps. Many of these programs can be traced back to the War on Poverty and Great Society programs launched by President Lyndon B. Johnson in the mid-1960s.

But progress in narrowing the economic divide between blacks and whites has stalled, and the time has come for a new national effort. Unlike in the 1960s, though, the battle can't be run out of Washington. It will require the efforts of all levels of government, as well as companies, schools, and individuals.

The place to start: with children. A recent paper by Nobel economics laureate James J. Heckman of the University of Chicago suggests that early intervention is the best way to eliminate racial gaps in college enrollment. In particular, intensive enrichment programs for preschoolers are effective in raising lifelong earnings.

Greater attention from parents would also help. Studies show that even after accounting for parental income and education, black parents are less likely to read aloud to their preschoolers than white parents, leaving many black children behind before they hit kindergarten.

Once black children enter primary school, smaller classes are immensely beneficial. In a Tennessee experiment called Project STAR, students were randomly assigned to classes with either 13 to 17 students or 22 to 25 students. The average test scores for black children in smaller classes jumped 7 to 10 percentage points. Whites' scores jumped 3 to 4 points.

Improving access to higher education is important as well. The Supreme Court recently affirmed the right of colleges to use race as a "plus factor" in admissions decisions. For most black students, though, the biggest hurdle to attending college is money. Yet because of cuts in federal aid and rising tuition, the Pell Grant, the core federal scholarship for needy students, covers less than 42% of the cost of attending a four-year public university, half that of a generation ago.

Funding cuts have shattered job-training programs—and this unduly affects African Americans. From 199 to 2003, the number of people receiving training through the major federa programs fell by three-quarters.

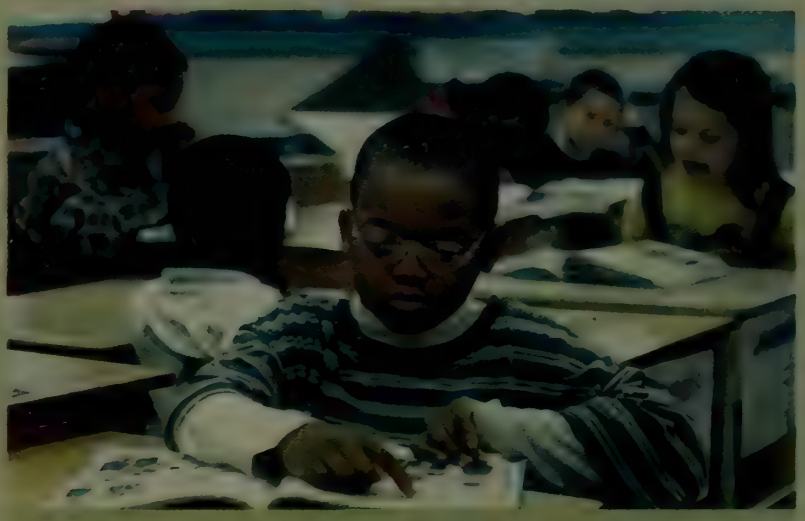
Employers, too, must take action. Detractors say that affirmative actio causes companies to hire and promot less qualified people. But a 1999 stud by economists Harry J. Holzer, now Georgetown University, and David Neumark of Michigan State Universi ty found "very little compelling evidence" that minorities hired under affirmative action perform worse than whites.

A proven way to increase black mobility is to add African Americans as board directors and top executives. Holzer studied a sample of companies and found that those with black owners or managers drew twice a many black job applicants as other companies. Companies with high-ranking blacks ma work harder to retain blacks, even during downturns. "'You came in yesterday, so you're gone tomorrow' is not the way we do business," says Lydia G. Mallett, chief diversity officer at General Mills Inc., where two of 13 directors are black.

Finally, when blacks are discriminated against in hiring or firing, companies have to be punished. Yet the staffing of the Equal Employment Opportun ty Commission has shrunk 17% since 1980 while complaints are up 50%.

Yes, there has been progress, but the racial divide has not closed. It's time for America to admit that—and do something.

Crockett covers soci issues from Chicago.



A REFORM AGENDA

What will it take for African Americans to catch up with whites? Some measures that could help:

SMALLER CLASSES Public schools should be given the money to cut class sizes. Research shows that black students benefit even more than white students from smaller classes.

JOB TRAINING Congress and the White House should agree to increase funding for job training.

AFFIRMATIVE ACTION To help African Americans overcome barriers to success, colleges and companies should make race a "plus factor" in admissions and hiring.

TOP JOBS Companies should bring in more blacks as board members and senior managers. That will lead to more hiring of blacks throughout the ranks.

ANTIBIAS ENFORCEMENT The Labor Dept. and the Equal Employment Opportunity Commission should step up efforts to eliminate racial discrimination in hiring and firing.

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Small Business

Checklist

f you're reading this, congratulations, you might be one of the scrappy companies that's driven the Russell 2000 small-cap index up nearly 4 percent from its 12-month low. Perhaps you are also positioned to ride the post-Iraq surge that's lifted the Dow Jones Industrial Average back to 9000 and has the Federal Reserve talking cautiously about a rebound.

Layoffs are subsiding, falling to 68,623 in May n 146,399 in April, according to a recent report by cago-based outplacement firm, Challenger, Gray hristmas Inc. The White House predicts President h's new tax-cut legislation will create 1.4 million s in 18 months; the less sanguine outlook is for a d as many: 130,000 jobs by the end of this year and ther 350,000 jobs in 2004.

And Congress also increased the equipment uction for small- and medium-size businesses to 0,000 a year, making it very appealing for entre- neurs to start spending money on vehicles, chinery and other equipment they need to get k in the game.

But before you rush out to hire 10 people and buy ,000 worth of office supplies, spend a few minutes ewing this checklist which is designed to help you elop a strategy for growth.

My checklist covers technology, communications expense management. There are no right or ng answers. Just answer the questions as hon- y as possible and use the answers to draft an on plan for your company.

hnology checklist:

Too many small- and medium-size companies chase hardware and software by following casu- dvice or because the owner has read about some l, new technology. Before you go shopping, ask rself these questions:

1. What kind of technology do our competitors use to beat us?
2. What can I do to make it easier for my employees to provide better customer service?
3. Who can help me make solid technical decisions?

Start by calling your industry trade association to learn what hardware and software options are coming into the market. If you don't have a tech-savvy person on your team, hire a consultant, but don't settle for someone who knows little about your industry.

WHAT COMMUNICATIONS TOOLS AND SERVICES WOULD MAKE LIFE EASIER FOR MY EMPLOYEES?

Small Business Checklist

In hardware the current buzz is mobility. Wireless connection nodes in cafes, offices and airports across the country, together with the new generation of notebook computers, many of which run Intel's Centrino connectivity chip set, can suddenly free your employees to do better work away from their desks. Notebooks by Dell, IBM, Hewlett-Packard and others are slimmer and lighter than the last generation's, and they operate faster but cooler, which extends battery life. Result: you can put more computing power in the field with off-the-shelf machines.

"For many small businesses that are ready to grow, you're talking about issues of outgrowing facilities—whether to add an office or other location," said Jim Porter, senior manager for Dell's Small- and Medium Business Division. "With mobile computing, the new generation of notebooks can help a business grow with very flexible options and with no sacrifice in reliability."

Software also is offering some new ways to enhance mobility. In April, Microsoft Business Solutions introduced "Business Portal," which allows remote access to data and operations through the web. A business can pinpoint the information it offers employees; salespeople can review quotas and enter orders; executives can review reports and look up critical information. "Because it's web-based, it's available everywhere and can be configured to deliver almost any kind of information to almost any user," said Lynne Stockstad, global product management for Microsoft Business Solutions.

You can also scale up your technology to meet your own needs as you grow. Keep in mind that your software now should be similar in feel to the software that will be there when you grow from an entrepreneurial to a mid-size concern, as you undoubtedly will. Challenge all your vendors and resellers to prove that they will be able to handle your needs for more email, e-commerce, web traffic, financial data, storage and whatever else you need, with the least amount of interruption and "change management."

Just coming into the mainstream are programs that increase the productivity of mobile compu when they are *off*line. IONA and other compa write products that allow notebooks to excha information with servers whenever the noteb spends time in a connectivity node. Good to k your road warrior's computer is on the job wher warrior is stuck in an airport security line.

A broader trend in software is to help the sr and medium-size business interact in very parti ways with corporate giants. This, I believe, is greatest advantage of technology: it levels the f Using tech to present yourself correctly, you can in your garage with a cat on your lap and still w six-figure order from a big corporation.

In March, the European software company introduced its BusinessOne package for s business. It aims to help a regional comp efficiently scale up to national and global m market standards.

"We can help the small- and medium size c pany enter the business stream with the Wal-M and Kmarts of the world," said Gary Fromer, senior president of SAP's small- and medium business sion. "You not only have to be able to talk to their and billing and distribution systems, but before ever receive an order you have to show your five plan for reducing your product cost. And, when truck shows up at your warehouse, if your boxes a closed and the labels ready to go when that w house door opens, you will be receiving a bill fo cost of empty shelves in the store."

With the right stuff, you can run your own s company to those standards.

Communications checklist:

1. What communications tools and serv would make life easier for my employees
2. Are we accessible to customers 24/7?
3. Would a toll-free number encou customers to call more frequently? Co also improve internal communications?

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DOES THE CARD PROVIDE ONLINE ACCESS TO ALL MY ACCOUNTS?

Small Business Checklist

business tool. It's nice that telecom companies are falling all over themselves for your business, but don't let it go to your head. I recommend using one company to serve as many of your needs as possible—until you find a better one, and it should be a *lot* better to justify the trouble to switch.

I believe an integrated approach saves you money in the long run because it simplifies your business. "Pick a reliable communications provider that has a diverse product portfolio and can be a one-stop shop for all your needs," advises Jeff Mott, vice president of marketing in Sprint's Mass Markets Organization.

Do not make telecommunications decisions solely on price. You want to be sure that if you have trouble with the lifeline to your business, your service provider will fix it fast.

I also like the high-end voice-mail systems that tell incoming callers about your products or services while they wait to be transferred. It serves both your customers and your employees. Paying a professional to record the message is worth it. Redundant but true: you have only one chance to make a first impression.

Financial management checklist:

1. Can I set limits on what my employees can purchase with a company-issued card?
2. Does the card provide online access to all my accounts?
3. Do employee accounts earn points for airline miles or a down payment on a vehicle and if so, do all the points roll up into one master account—mine?

The simplest way to manage cash flow is to be vigilant about what you're spending. Credit cards have two great advantages: you can use them to pay your bills over time while getting paid quicker if you have a merchant credit-card account.

American Express offers sophisticated reporting of expenses by employees, and other credit-card companies are launching innovative credit cards specifically for small business. One rolled out in May by Chase is perfect for a business with a fleet of vehicles. (A partner on this particular card, a MasterCard GM.) Expense reports from the fleet can be custom by vehicle, driver, transactions and more. As with er cards, you can review expenses online; no wai for a mailed report. "Employers can also choose spe ing limits for each employee and easily monitor transactions," said Rajive Johri, executive vice pr dent of marketing, Chase Cardmember Services.

If the card rewards spending by giving away line miles or a similar perk, insist on keeping all points in one master account, as the larger com nies have done for years. You don't want employee to pull down a trip to Hawaii on your ca bonus points just because he bought two cem mixers for the business.

If you've answered the questions from top bottom, you've got a good start on growing business from what seems to be the bottom of economic downturn. It's a buyer's market in tech telecom. And it deserves mentioning that there plenty of good people out there to choose from,

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Written by Jane Applegate. Ms. Applegate is auth of "The Entrepreneur's Desk Reference" and "201 Great Ideas for Your Small Business," published b Bloomberg Press. She is executive producer of Th Applegate Group, a multimedia production compa based in Pelham, N.Y.

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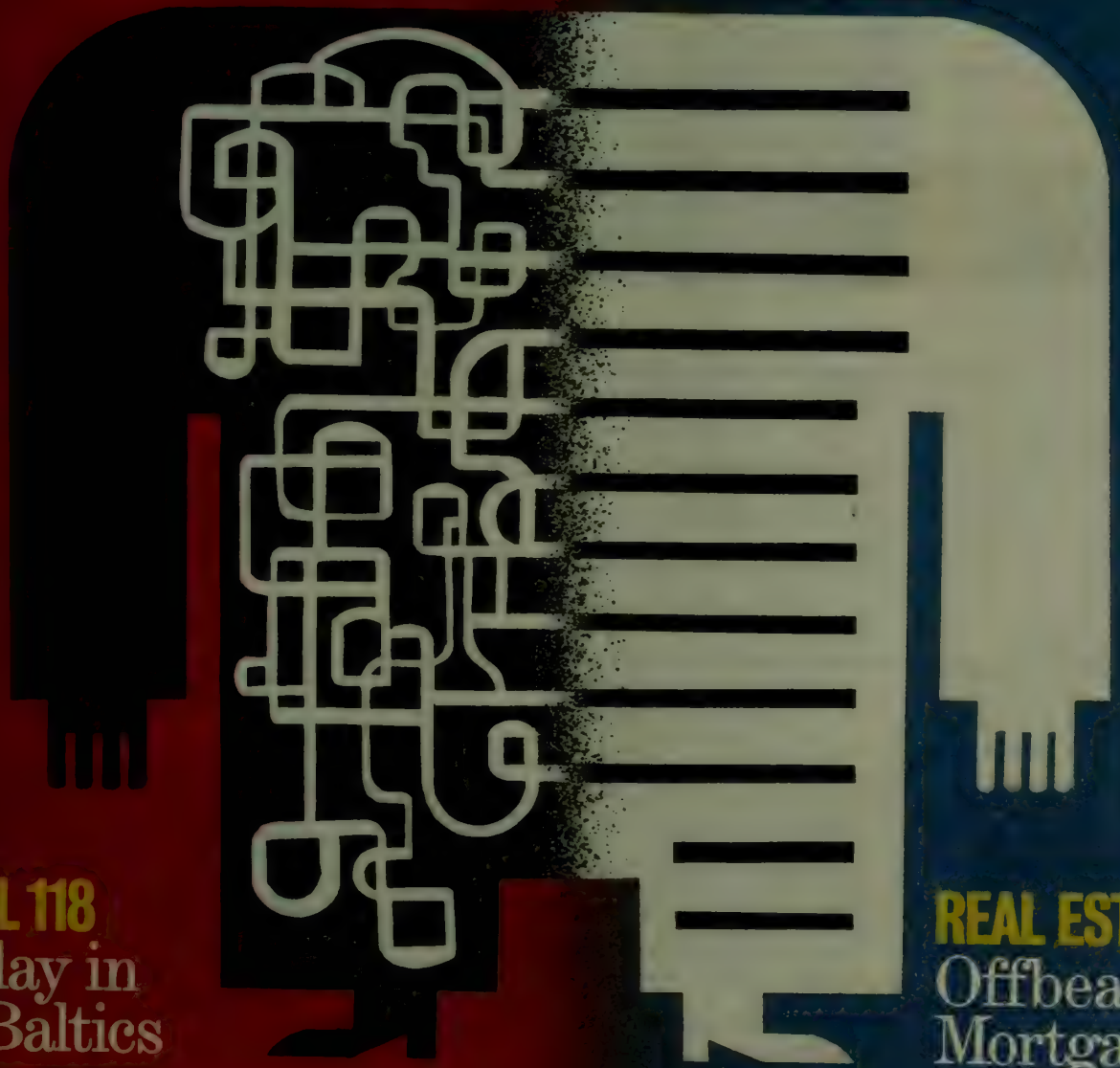

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CENTU
Investment M

dividends

tips, tidbits & more

EDITED BY TODD GUTNER

THE STAT

71.1

CENT of the 1,750 ey-market mutual funds ielding less than 1% on nualized basis. Some % of the funds yield less 0.5%, and 3.7% pay han 0.25%.

Data: Money Fund Report

R HOME

MING THE ARAGE

nany homeowners, the ge is a room you can't —a jumble of tools, and odds and ends that it impossible to park ar. Here are a few or- ing tips to help:

EATE A PLAN: Take urements and decide in nce where tools, sports and gardening equip- will be stored.

EXIBLE: Modular shelv- ystems can help maxi- and easily reconfigure space. Available from **geTek (866 664- 4)** or **Gladiator geWorks** (866 342-).

OK UP: Hang bikes, , and other large items the ceiling.

SUMMER READING

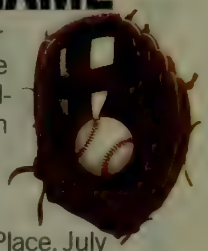
Books to Bank On

IF YOU HAD A NET WORTH OF at least $25 million, what would you be reading on the beach? Clients of **JPMorgan Private Bank** don't have to think about it. Up to 10 recommended titles would already be at their door. The summer reading list started in 2000 after bankers noticed they were often asked by clients for book suggestions. CEO Maria Elena Lagomasino decided to formally poll bankers. The ideas go to an eight-member committee, which selects 25 books. **A six-person reading group whittles down the list to 10,** from which bankers pick titles to send to clients worldwide.

The most popular title is *Geeks and Geezers*, a tome on leadership by Warren Bennis and Robert Thomas. Given the bank's pedigree, former Chase Manhattan Chairman David Rockefeller's *Memoirs* is a natural for the list. Most surprising is *Soul Mountain*, a dense semi-autobiographical novel by China's Gao Xingjian, a Nobel laureate in literature, published in 2000. It takes the reader "to a different place of reflection," says Lagomasino. It's not often bankers do that for clients. (For the full list, go to businessweek.com/magazine/extra.htm) *Lourdes Valeriano*

TIME OFF

WHERE TO GET GAME



No tickets for Major League Baseball's All-Star Game on July 15? Try **FanFest** at Chicago's McCormick Place. July 11-15 ($16 adults, $11 kids). Hit balls seemingly thrown by New York Yankees ace Roger Clemens, whose lifesize image is projected on a screen. Retired Chicago Cubs shortstop Ernie Banks and others will sign autographs.

PETS

CREATURE COMFORTS

Fat cats aren't just found on Wall Street. More overweight cats (and dogs) live in Fort Lauderdale than in any other U.S. city. That comes from a **Purina Pet Institute** survey of 5,000 U.S. veterinarians ranking 50 cities by 30 pet criteria. Some highlights:

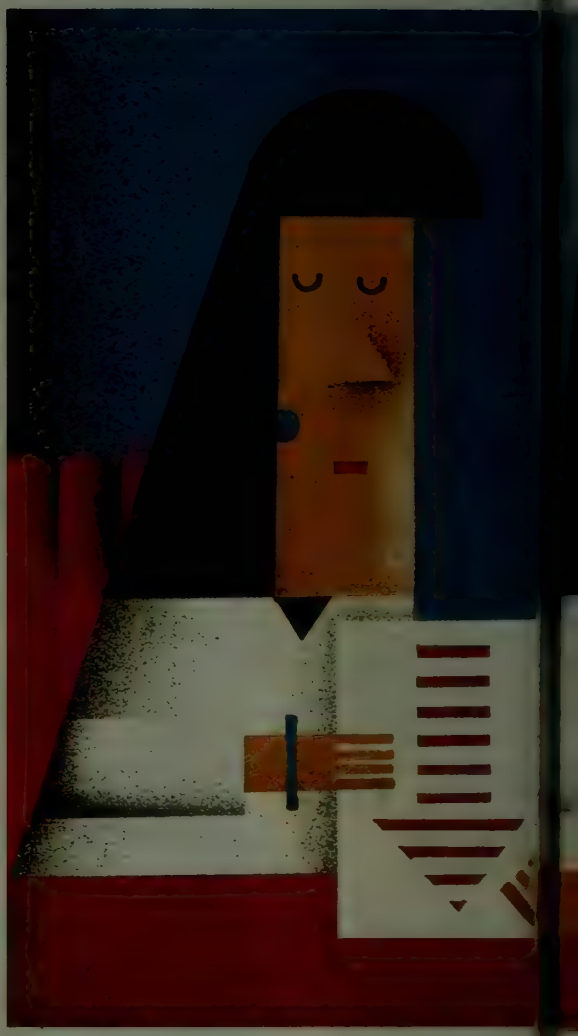
DENVER: Healthiest animals (high neutering rates; few fleas)

RIVERSIDE, CALIF.: Unhealthiest (bad air quality, too few vets, too many fleas)

NEW YORK: Best dental care (affluent residents spend more on pets)

PORTLAND, ORE.: Strictest animal protection laws (high fines for abusers)

The Résumé Doctor Is In



Specialists can help you craft a document that gets results. Here's how to find the best help. BY MICHELLE CONLIN

IF YOU ARE ONE OF the legions who've been axed, downsized, or dissolved, you may find yourself hovering over your PC, frantically updating your résumé. If it has been a decade or so since you've done this, you'd be wise to apprise yourself of some new trends swirling about in curriculum-vitae land. It can make the difference between cranking out a punchy masterpiece—or a jargon-ridden loser certain to never see the dark side of an HR department scanner.

Take the summary section. Never heard of it? It's the practice of bulleting key achievements underneath your name. Some of these headliners blather on for nearly half a page before moving on to work experience. But anything longer than a few sentences is seen by some as a sneaky way to hide big gaps in employment or ultra-short stints. Moreover, long summaries can leave the reader with no idea as to when and where your achievements occurred.

Even if you knew that, consider this: Nearly all the top headhunters and outplacement specialists we consulted said 90% of the résumés they see are riddled with errors or misrepresentations, including "sales manger" for sales manager, "skilled in massaging" for messaging (this from a Wharton MBA), and "on contract with the state" (in

That's why you might want to sider hiring a résumé doctor. Su specialist can help you craft a docu that teases employers with your ju career achievements without des ing your allure. Think of it as a r trailer for your career. Its purpo to get you in the door so you ca swer questions face-to-face—not overloaded sheet of paper.

There are legions of c.v. surgeon there. You can find them on the W outplacement and headhunting firr even on the bulletin board of your coffee shop. They usually charge where from $40 to $200 for a quic do to $5,000 for the five-star treat

LESS IS MORE: A résumé that rambles on induces boredom. Short and punchy wins the job offer

BEFORE

Marketing Manager, Oracle Support Services (9/98-2/00)

Initiated competitive analysis and market research projects to identify and help design support offerings Oracle's Support Services Division. Worked with industry analysts to develop evaluations of Oracle Supp Services for strategic marketing collateral.

- Obtained "Best-in-class" reviews for Oracle's web-based and High Availability services through the commissioning and strategic support of analyst evaluations by Gartner/Dataquest and IDC.

AFTER

Marketing Manager, Oracle Support Services (9/98-2/00)

5500+ employee P&L center, direct report to Vice President, Support Service Marketing.

- Managed $350K annual market research budget, obtained "Best-in-Class" reviews by Gartner/Dataquest & IDC

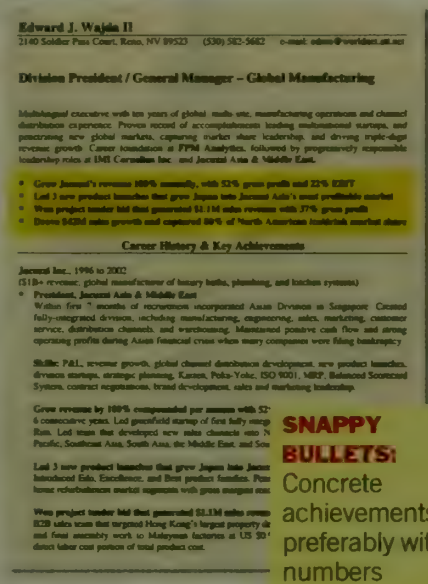
pn.
rketing and

- Grew Jacuzzi's revenue 100% annually, with 52% gross profit and 22% EBIT
- Led 3 new product launches that grew Japan into Jacuzzi Asia's most profitable ma
- Won project tender bid that generated $1.1M sales revenue with 37% gross profit
- Drove $42M sales growth and captured 80% of North American ice/drink marke

Downing, managing partner at Cleveland-based executive headhunting firm WorldBridge Partners; John Lybarger of Career Architects, based in Denver; and Tamar Shay of Roslindale (Mass.)-based Shay & Tannas, which specializes in "inoculating résumés from environmentally or biologically induced ADD."

So how to go about screening for stellar assistance? First, ask for samples of previous work. The average manager will spend but a few seconds scanning a résumé. So start with the superficial. Have the margins been pushed to the outermost reaches of the page to accommodate muddled thinking? Exemplary résumés breathe with ample white space to make key information easy to absorb. Unless you're a senior executive, avoid the now rampant practice of extending it beyond a page.

Unfortunately, the less-is-more philosophy is the hardest thing to execute. An easy formula: bullets that billboard your accomplishments. A good résumé doctor will elicit your inner braggart by grilling you for context and quantification: How big was the division you were running and by what percentage and in what time frame did you increase profits? Was the economy mired in a recession at the time? "I had one guy who had added $3 million to the bottom line, and he didn't even have it on his résumé," says Downing.



Edward J. Wajda II
2140 Soldier Pass Court, Reno, NV 89523 (530) 582-5682 e-mail: edwa@worldnet.att.net

Division President / General Manager – Global Manufacturing

Career History & Key Achievements

SNAPPY BULLETS: Concrete achievements, preferably with numbers

BE SPECIFIC: When summing up your career, generalities won't get you anywhere

Avoid meaningless phrases ("innovative problem solver with business acumen and emotional intelligence required for achieving 21st century business imperatives") and schlocky testimonials ("project viewed by some as virtually impossible!"). Focus on the past 10 years of your employment history. Jobs held prior to that can be summarized at the end.

Another trend: the inclusion of personal information. The only such details that belong on your résumé are those that buttress your case. Saying you jog is irrelevant. But including that you ran the Boston Marathon might show your perseverance and an ability to operate under pressure. So might clocking 1,300 hours in a Phantom F-4 during the Gulf War. Does your job require heavy networking? If so, a low golf handicap is a major plus.

Once your résumé doctor hands the polished makeover back to you, give it to three of the most anal-retentive people you know. Challenge them to find a single mistake.

In the end, it's likely that no one—not even the boss who hires you—will read your résumé word for word. But it must be flawless nonetheless. Especially in a job market like this. ■

h includes cover letter assistance ell as hours of hand-holding.
ut be careful. Résumé revamping is gely unregulated field rife with sham marians, sloppy formatters, and y "career-repurposing" poseurs who ise access to "hidden job markets" don't exist. One alleged expert—mmended by a top-five executive hunting firm—sent us a prized over performed Wall Street in- ation-technology utive. Under- the candidate's e was a short nary that began: "Proven of increasing operational encies." When we pointed hat the word "record" missing, the résumé doc- efended the sentence, only to even- cave: "We don't write in perfect nces," he explained.
at's not to say that all 21 of the ré- doctors we encountered were a pointment. Among those we felt d craft the clearest, most data- résumés: Mike Jeans of Boston acement firm New Directions; Jack

BEFORE

Has expertise in virtually all phases of editorial communication, and enthusiastically works on projects from initial conception to finished product.

AFTER

Award-winning executive with career foundation as founding employee and Executive Producer at CNN. Proven record of accomplishments leading startups, capturing market share, driving revenue growth and creating strategic marketing and public relations campaigns.

HISTORIC PORT: Tallinn in Estonia has spectacular architecture

Beguiled By the Baltics

The sights are rich, and the costs low. BY DAVID FAIRLAMB

THE COBBLED STREETS are wonderful, and the centuries-old buildings sublime. But one of the finest things about vacationing in Tallinn, the capital of Estonia, is the cost. A bean soup and broiled pork lunch at Eesti Maja, one of the best Estonian food restaurants in the city, will set you back $8; a spacious sea-view room with breakfast for two at the monolithic Soviet-style Best Eastern Pirita Top Spa hotel comes in at little more than $70. Tourists can have a great time in this lively historic port without breaking the bank.

It's the same in the Latvian capital, Riga, and its Lithuanian counterpart, Vilnius. Despite the average 20% rise in the countries' currencies against the dollar over the past 12 months, both cities offer excellent value. Food and accommodation aren't the only things that are cheap—so are dental work and medical treatment. An increasing number of visitors to Latvia, which has a surplus of doctors and a reputation for good private health care, come especially to have their t
taken care of, and eve
undergo heart surg
Call it me
tourism.

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three cities became
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where Swedish, Rus
and, especially, Ger
merchants mingled
the local population.
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Olaf's church in Ta
and St. Peter's in
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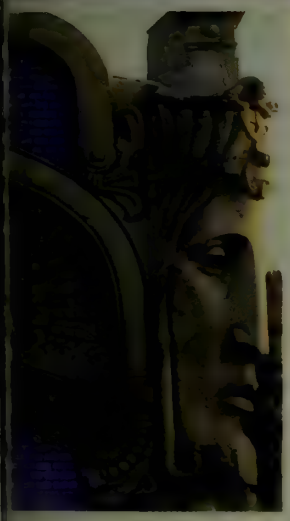
ment to the leading
that German-spea
traders played in
cities.

The richer they
came, the more th
habitants of the Baltic capitals spent on their ho
churches, and guildhalls. The results are spectacular. De
repeated wars, fires, and, most recently, 50 years of S
occupation, much of the old architecture has survived i
Witness Vilnius: The city is packed with m
ments. In addition to the medieval Midin
Gate, there are 15th to 18th cen
palaces, the city hall, and numerous
gious buildings, including 20 Cat
churches, four Russian Orthodox ch
es, several synagogues, and a handf
monasteries. The combination of sty
Gothic, Renaissance, Classical, Mo
and Baroque—makes the old city ce
especially attractive.

The mix of cultures evident in Balti
chitecture is borne out in the local food.
basic cuisine tends to be hearty, based on
and herring. It is heavily influenced by Sc
navian and Russian tastes. That's especially tr
Riga, where most people still speak Russian. Many
restaurants serve dishes such as *pelmeni* (dumplings),
(pancakes), and *shchi* (cabbage soup). Diners' favorite t
seems to be vodka.

One of the best ways to sample local fare is to eat d

RIGA ALLURE: Both Latvian cuisine and buildings show a mix of East and West



at the massive Lido Mills restaurant complex, just a five-minute drive from the center of Riga. It's worth going just to see the building, a modern wooden structure linking numerous thatched huts and a giant windmill. Here up to 1,500 people a night eat Russian and Latvian food in a variety of self-service restaurants on three floors. Vodka and beer are plentiful ieap, and there's even a dance floor, which is packed on nds. A three-course dinner for two, with a bottle of comes to less than $25.

Baltic peoples—who are famous for their melodious ongs—know how to let their hair down. Fun-loving rs shouldn't miss a night at Pepsi Forums, a disque in Riga where Russian techno music alternates Western pop.

Russian presence remains strong in the Baltic states. country was part of the Russian empire until just after volution of 1917. After they were annexed by the So- Union in 1940, the government in Moscow shipped people from Russia to live there. But it's Finns, rather Russians, doing the large-scale partying most weekends linn. The ancient port is just an hour by ferry from ki, and Finns come over by the thousands in search of handicrafts and drink.

of the best ways to see the Baltics is to sail from holm or Helsinki to Tallinn, then drive overland to and Vilnius. Large swathes of the countryside are un- d. The bogs of Estonia are oddly soothing, and the s of Latvia and Lithuania are full of wildlife. The in- ucture outside the cities often leaves a lot to be de- —a half-century of Communist rule has seen to that. e in shops and restaurants can be slow. But most are friendly and welcome tourists warmly. And they harge an arm and a leg. ■

OUTDOORS

Summer Skeeter Stoppers

Get ready to slap and scratch. Mosquito season is back with a vengeance because of higher-than-normal rainfall in some parts of the country. How can you avoid the itch as well as mosquito-borne illnesses such as West Nile virus?

■ **REPEL THE SUCKERS** No one product wards off all 170 mosquito varieties in the U.S. But lotions containing DEET (N,N-diethyl-meta-toluamide) work best, says Jim Olson, an entomologist with Texas A&M University. The concentration doesn't denote effectiveness, only how long it works. So 23.8% DEET products work for about eight hours, while 4.75% products last about 1½ hours. Use no more than 10% for kids.

If you'd rather avoid chemicals, try herbal repellents. A good one is WPC Brand's new Repel, made from lemon eucalyptus. Avon Products' Skin-So-Soft is also nontoxic. (The original bath oil works better than the Bug Guard Plus lotion.)

There is anecdotal evidence that suggests taking a B-complex vitamin or eating brewer's yeast, which is high in B vitamins, repels insects. Similarly, Bounce dryer sheets may provide protection if you rub them on your skin and hang them from your belt loop.

■ **RUB THEM OUT** Another tactic is to treat clothing or mosquito netting with permethrin, a synthetic version of pyrethrum, which is derived from chrysanthemums. An insecticide, permethrin kills mosquitoes rather than just repelling them. You can buy it in aerosol cans at sporting-good stores. Spray your outdoor work clothes, let them dry for two hours, and you've got mosquito armor that lasts two weeks.

Don't waste money on sonic devices. "Manufacturers sell 2 million to 3 million of those per year, and they don't work," says Donald Barnard, entomologist at the U.S. Agriculture Dept.'s Agriculture Research Service in Gainesville, Fla. Electric bug zappers kill more beneficial insects than mosquitoes.

■ **DON'T LET THEM BREED** Get rid of standing water around your house, even in something as small as a bottle cap. Make sure your rain gutters drain completely. Put larvacidal dunks containing *Bacillus thuringiensis israelensis* (Bti) in water you can't drain. Finally, don't forget to empty the water from the dishes under your houseplants. Otherwise, you'll wind up with a mosquito maternity ward in your sun room. *Kate Murphy*

MOSQUITO SEASON SHOULD BE A DOOZY

Home Loans With Bells And Whistles

Some new twists on mortgages offer more flexibility—for a price. BY ANNE TERGESEN

If you're shopping for a mortgage—and with interest rates at a 45-year low, who isn't?—there are some new twists to consider on the standard 30- and 15-year loans. For example, you can get a loan that allows you to skip payments. And a new portable mortgage locks in today's low rates—not just for this house but for the next one, too.

You'll pay for these perks, however. Some lenders charge extra fees, while others jack up your interest rate a bit. If you examine them closely, you may discover you'll come out ahead with conventional loans.

THE PORTABLE LOAN

E*Trade's new Mortgage on the Move offers a unique solution: It allows you to take your interest rate and the balance on your current mortgage to your next home. That's a neat feature if you think you'll be moving in a few years and want to lock in today's low rates. (The loan isn't available to refinancers nor to those making downpayments of less than 20% of the purchase price.) You can transfer the mortgage only once. If you need additional funds to finance your next home, E*Trade will underwrite a new loan at the going rate on a regular mortgage.

The catch is the interest rate. E*Trade adds about 0.6% to the fixed rate on a conventional 30-year loan. As a result, you'll pay about 6% today, vs. 5.4% for a regular mortgage. If you have a $300,000 mortgage, portability adds $114 to your monthly payment.

Move ahead five years, and the portable loan will have cost you about $9,000 more in interest than a regular loan at 5.4%, calculates Keith Gumbinger, vice-president at mortgage-tracking firm HSH Associates in Butler, N.J. Assuming you move then, and interest rates on regular loans are at 6.5%, you'll have to hold onto the portable loan for five more years before you recoup that extra $9,000, vs. a new loan at 6.5%.

If you know you're going to move, another solution is a mortgage that offers a fixed rate for a set period, such as three, five, or seven years, and floats afterwards. For example, you can now lock in 4.28% for five years. Someone with a $300,000 mortgage would about $320 a month at that ra paying 6% for the portable loan.

HOME EQUITY/MORTGAGE COMBO

Another new twist on a mo automatically converts your dov ment into a home-equity line of One such offering, from Wells increases your credit line quart you pay down principal and annu reflect any increase in your hom ue. (If your home's value falls, t remains the same.)

Although this combo saves on work, you can probably do bette separate loans. That's because i credit line's balance is $20,000 low—or if you opt not to activa line—you'll pay Wells Fargo a $ nual fee. Not all home equity charge fees. Moreover, the credi variable rate, currently 4.5%, is s above Wells Fargo's prime lendin Some lenders now offer rates of u half point below prime, says Gum If you want to lock in a fixed r your credit line, Wells allows convert some or all of it to a ho uity loan for a $50 fee. But the c rate, 7.375%, is slightly above t tional average, Gumbinger says.

DEFERRED PAYMENT OPTIO

Finally, if you're w about a layoff or just n skip a payment no then, a loan av through a limited n of Fannie Mae-ap lenders allows you fer two payments and 10 over the li 30-year loan.

You'll pay a f these loans, which names such as Pa Power. A lender o this product, Countr Home Loans, lets you ther about 0.5% to 0.7 your whole mortgage up to skip all 10 payments, or 0.25% to 0.375% up front charge of $100 to $230 each tim want to skip. The up-front char change daily. A cheaper alternati is to borrow on a home-equity credit at about 5%. On a $2,000 r ly mortgage payment, interest run about $8.33 a month. Of c since rates change, so will you ment. But even if rates rise, you' ter off borrowing to cover a pa rather than paying to stop it.

David Latter, Chairman, Morehouse Foods

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works well with family-owned business

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BAD NEWS: Pohndorf found out his whole-life policy was about to lapse

Is Your Policy Getting Zapped?

Swapping insurance coverage may get you out of the jam.

BY LEWIS BRAHAM

DAVID Pohndorf, a 60-year-old Far Hills (N.J.) resident who raises money for venture-capital funds, recently received a letter from his insurer telling him his whole-life policy was about to lapse. The reason: The $6,200 balance on a loan he had taken out 33 years ago against the policy now almost exceeded the policy's cash value. "I was shocked," says Pohndorf. In the past, the cash value—the initial premium he had paid plus the investment return generated by the insurer—had grown fast enough to cover the loan's interest and then some. Pohndorf hadn't paid a premium in 20 years.

Falling interest rates and years of deteriorating stock prices have taken their toll on the dividends that insurers pay to policyholders. Yet the rates on policy loans today can be fixed at about 6% or 7%. Even if they're variable, they may not have fallen as much as policy dividends. If those payouts are no longer high enough to service the loan, the unpaid interest gets tacked onto the balance. If a loan exceeds the cash value, the insurer will terminate the policy.

It gets worse. When an insurer terminates your policy, chances are you'll have "phantom income," and the Internal Revenue Service will want its cut. Say you put $50,000 into a policy as an initial premium, and its value rises to $100,000 over 20 years. During that period, you borrow $70,000. If the loan's unpaid balance grows to $100,000, the policy lapses with no value, but the IRS treats it as if you received $50,000 in income. The best way to avoid this scenario is to pay off enough of the loan to keep the policy in force.

When an insurer terminates your policy, chances are you'll end up owing the Internal Revenue Service, too

But what if you don't h the money? You could ask a "1035 exchan which, in effect lows you to s your policy for other one. could move int universal life cy, which un whole-life policies, have fl ble premiums and death b fits. Opting for a lower mium would leave you extra money to pay the l

Suppose you trade in whole-life policy with $100,000 cash value an $70,000 loan balance for a versal life policy. With su policy, you can withdraw much as the amount you in at the outset, in this $50,000, without tax co quences. You can use money to pay down the $70 loan. That would leave with a much smaller debt well as a lower death bene

Such exchanges can you, though, through exit or premium hikes. "If bought a policy at age 35 you're now 60, the new mium will be higher if yo in bad health," says Jos Godfrey, an insurance bro at American Business & fessional Program in New York.

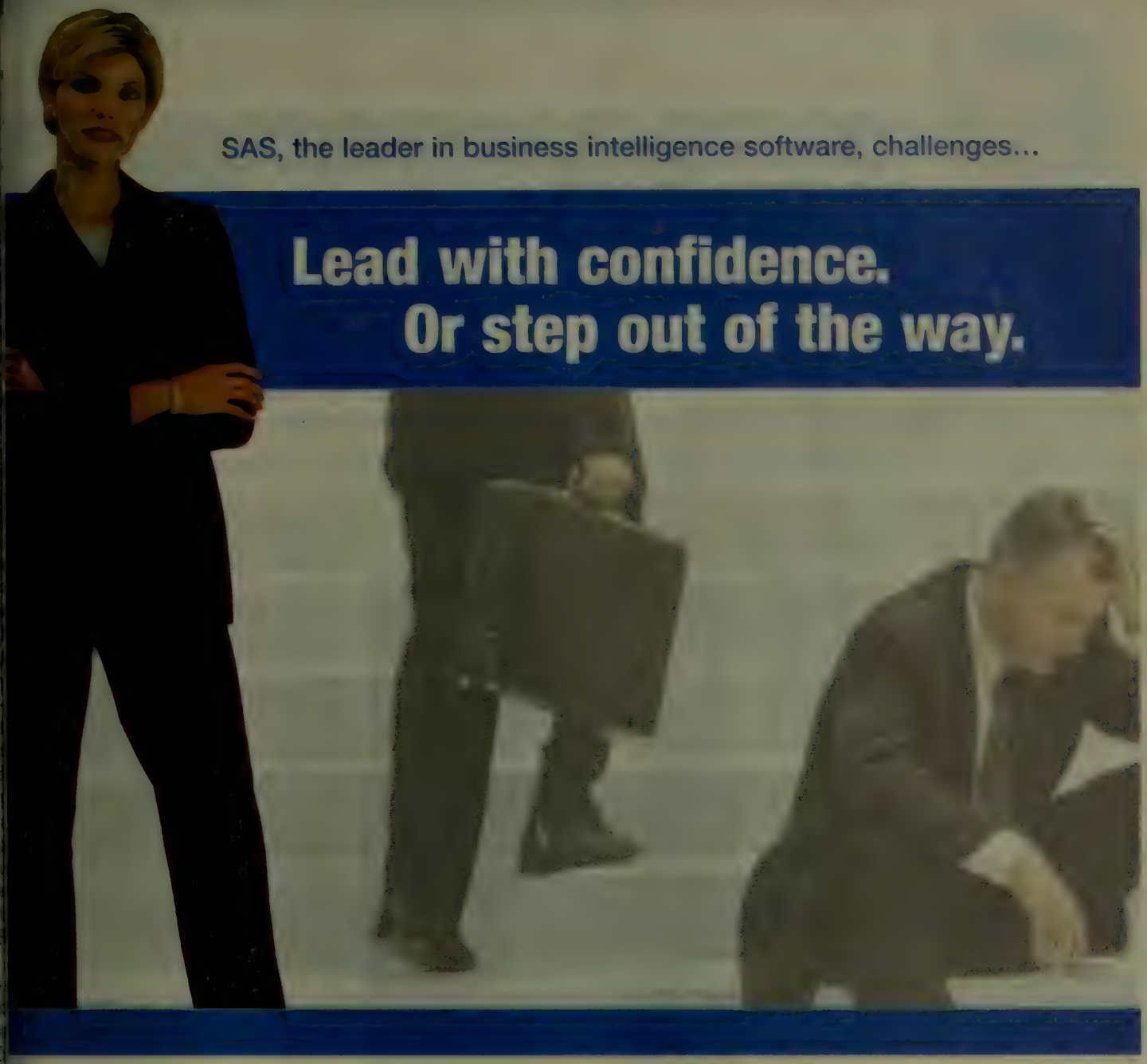
Also, you may pay commissions the new policy that nix the benefi the swap. Keith Maurer, an insur consultant for financial planners in T pa, knows of three insurers—ING So land, Ameritas, and Security Lif Denver—that offer exchanges from er insurers' policies with no com sions or commissions of less than "In 90% of these exchanges, I've sa people money," he says.

Before you make the exchange, if your insurer offers any solutions. S will provide debt counseling to pe who are strap Your agent can help you unders the details of y contract, so you make costly mistakes.

Since insurance contracts vary gr ly from policy to policy, there is no size-fits-all solution to this loan prob In Pohndorf's case, he simply wro check to pay off the balance. Not e borrower can afford to do that.

SAS, the leader in business intelligence software, challenges...

Lead with confidence. Or step out of the way.



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ARE THESE SHAREHOLDERS BEIN FROZEN OUT?

BY ROBERT BARKER rb@businessweek.

NO MATTER WHAT SOME nostalgic baby boomers may tell you, *Get Smart* was a truly dumb TV show. It did, however, come up with one brilliant gag, the "Cone of Silence." This clear plastic dome descended over Maxwell Smart, Agent 99, and their fellow spies to keep secrets from the wrong ears. Dumb, but so dumb it was funny.

Less amusing is the cone of silence too often used these days by public companies. The latest Case of the Corporate Cone centers on a small but promising Santa Barbara (Calif.) outfit called Fidelity National Information Solutions. FNIS sells real estate database tools and software, notably Paragon MLS, which helps agents troll multiple listing services. FNIS also is bent on revolutionizing appraisals. Instead of sending appraisers out to size up houses, FNIS reckons their value by plying mathematical models over oceans of market data. Wall Street sees FNIS' profit this year growing 32%, to $1.28 a share, on $503 million in revenue.

In May, though, something happened. FNIS shares leaped over $26 from under $20. Fidelity National Financial, the nation's top title insurer, with $5.1 billion in revenue last year, owns 66% of FNIS. Having recently acquired another real estate data company, FNF decided it also wants to own all of FNIS by buying out public shareholders. For each of their shares, FNF is offering some of its own stock, lately worth about $25 per FNIS share. A fair bid? Maybe, particularly given the nice premium over FNIS' pre-offer price. Yet if you think about it, you may start wondering why FNF would pay a penny more than it might get away with. That, after all, would only cost its own shareholders.

Dwell on it a little more, and you realize that as FNIS' controlling shareholder, FNF probably enjoys the best possible fix on the key variable that will determine the winner in this deal—FNIS' future earnings. If profits grow more rapidly than the market now expects, that's all to the good for FNF, while FNIS shareholders will have sold out too soon, too cheap. Standing in the way of such an outcome are four men, FNIS' independent directors. They have formed a sp committee to consider FNF's offer. (Seven men make up entire FNIS board, but three—Chairman William Fole CEO Patrick Stone, and FNF director Cary Thompson—first allegiances to FNF and so now are out of the FNIS

Will the independent directors do a good job? Early are not encouraging. The directors released word of FNF at 6:31 p.m. EDT on Friday, May 23. I don't know about but at that moment I was already into my Memorial weekend. After a few bare details boilerplate assurances that the sp committee would do the right thing, came the Cone of Silence. Through 30, FNIS had issued no more news. ing about who is on the special comm or who is its chairman, lawyer, or in ment banker. Not a word on how it evaluate FNF's bid, what alternative pursuing, or when it will report t vestors. Via phone, e-mail, and a sage passed on by FNIS Chief Fina Officer Neil Johnson, I tried to reac dependent directors in hopes of lea more. No luck. "They have kind of ' knit' themselves," Johnson told me.

Willie Davis, a onetime football and president of radio company Al Broadcasting, is the most experie of the four. He sits on the boards other public companies, plus St Funds and two universities. Ric Freeman is an investment manager in March left his position at Cer Capital Management. Earl Galleg

Real estate company FNIS says a buyout is under rev by a committee but won't say who's on it, what optio it's considering, or when it will report to investors

a data-processing consultant. Richard Mendenhall, who j the board in January, owns real estate agencies in Mis and served in 2001 as president of the National Assoc of Realtors. At last report, he had no stock or optio FNIS. The others held options, but only Freeman o FNIS stock outright, a total of 1,663 shares.

If I held stock in FNIS, I would like to hear these guy lering: "Look! FNF wants your shares. But we're on side. Here's our plan for protecting your interests—an the way, anybody want to make a counteroffer?" Instea only sound has been silence. You could make a TV about FNIS and call it *Get Dumb.*

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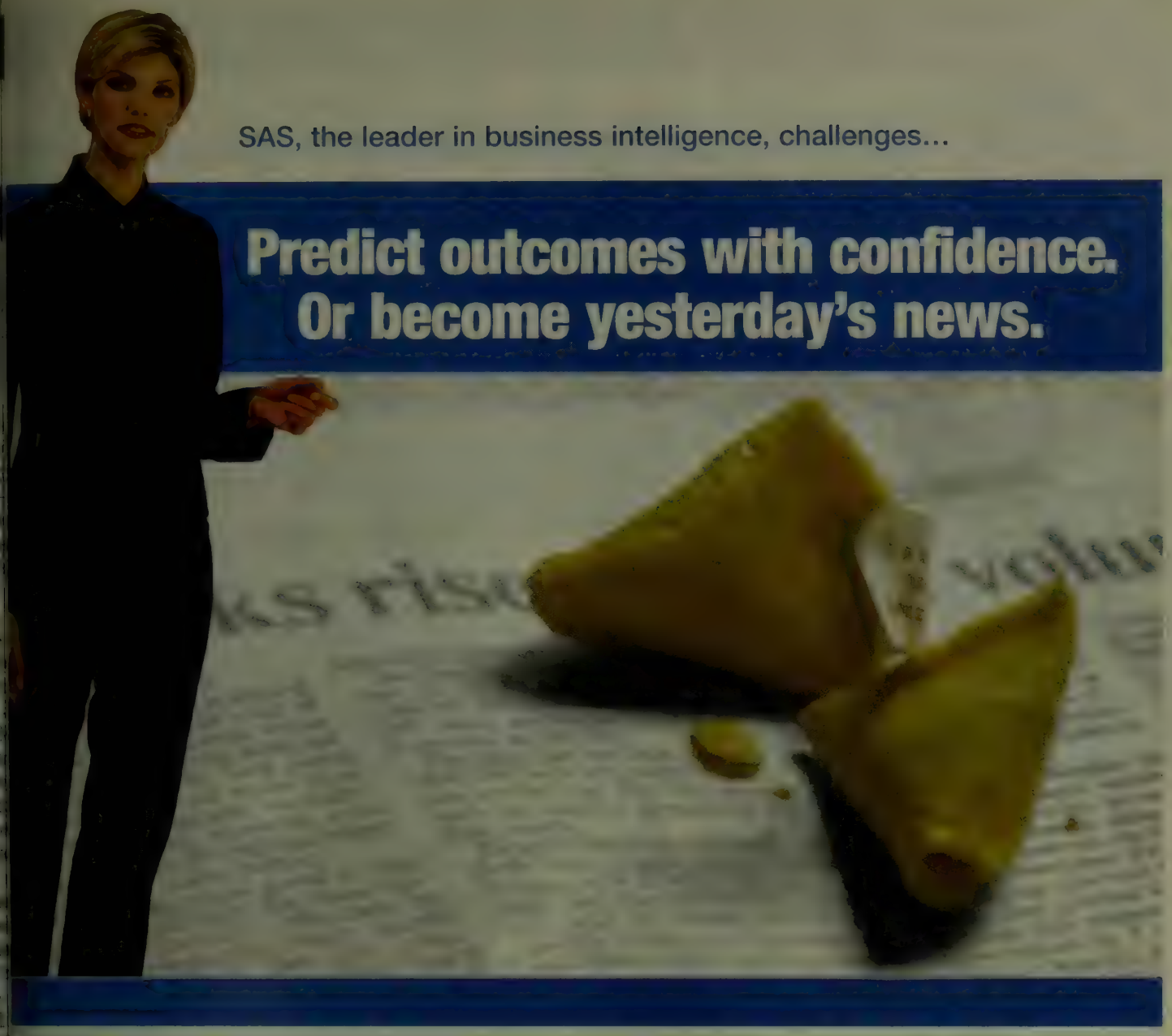

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FARM SALES ARE BRINGING A RICH HARVEST AT TRACTOR SUPPI

A NEW CELL-PHONE RULE MAY PUT POWERWAVE GEAR IN DEMA

NOW IN THE INTER PARFUMS STABLE: DIANE VON FURSTENBERG

BY GENE G. MARCIAL

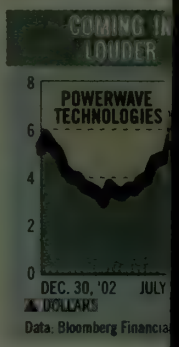
Tractor's Fertile Soil

Tractor Supply (TSCO) might sound dull, but this little-known farm-and-ranch outfitter is a winner on Wall Street. With 433 stores in 30 states, Tractor caters to part-time and hobby farmers, selling small tractors, animal and pet food, and garden tools. The company exploits niche markets where Wal-Mart and Home Depot don't tread. As a result, sales and earnings have blossomed. And Tractor's stock has shot up from 30 in early March to 47.41 on July 1. Has it peaked? Not quite, say fans. When Tractor hit 60 a year ago, the stock split 2-for-1. Now, some analysts predict another split: They see the stock hitting 60 again—sometime in 2003. Tractor's "competitive landscape and unit growth prospects are among the most favorable" in specialty retail, says Jenny Hubbard of Avondale Partners. She says Tractor is undervalued: Among its peers, the average price-earnings ratio is 17. Tractor trades at 14.8 times Hubbard's 2004 estimate of $3.16 and 17 times her 2003 figure of $2.75. Tractor earned $1.92 a share in 2002. First-quarter sales surged 41%, to $273.8 million, and 2003 sales could total $1.3 billion to $1.4 billion, vs. 2002's $1.2 billion. Tractor is in a much earlier stage of growth than most other retailers, she notes, "and with a market cap approaching $1 billion [now $882 million], it will gain more institutional interest."

John Lawrence of Morgan Keegan, who rates the stock "outperform," says that by "simply listening to customer demands," Tractor keeps its inventory "fresh and relevant."

Powerwave Could Surge On Movable Phone Numbers

Phone users won't be the only ones to benefit from a government edict that will force wireless phone companies to let customers keep their phone numbers when they change providers: Powerwave Technologies (PWAV) would also win. With Verizon deciding in late June to embrace the portability rule, which takes effect in November, the phone companies' opposition may soon unravel. Powerwave supplies radio-frequency power amplifiers to wireless networks. "The great rush will be to provide better phone service to keep their customers," says David Rocker of Rocker Partners, which owns nearly 10% of Powerwave stock. A highflier in the heady days of when it traded at 70, the stock is now at 6.33. Cell-customers are likely to switch and take their numbers with them, he says, if they aren't satisfied with service. Powerwave's amplifier, used for a variety of frequency ranges and transmission systems, helps improve reception. In May, Powerwave acquired assets from Ericsson Amplifier Technologies. In turn, it will supply amplifiers to Ericsson, which will use certain Powerwave products. Ken Muth of Robert W. Baird, who rates Powerwave a strong buy, expects a loss of 35¢ a share on sales of $226.5 million in 2003 and of 7¢ on $257.9 million in 2004.



Smelling Sweeter At Inter Parfums?

In August, a new Diane von Furstenberg brand w Burberry, S.T. Dupont, and Christian Lacroix unc umbrella of Inter Parfums (IPAR), which license distributes fragrances and cosmetics. The goa Inter Parfums CEO Jean Madar, is to launch a von Furstenberg Beauty line of scents and cosmetics, to the appeal of Inter Parfums, which is growing fast, in ste its mass-appeal products such as Aziza cosmetics an mate health and beauty aids. Michael James, a part Kuekenhof Capital Management, which owns shares, sa with its "pristine" balance sheet—no debt, a cash hoard of $40 million, or $2.10 a share, and fast-growing sales and earnings—Inter Parfums is undervalued. The stock, now at 7.62 a share, is up from 6 in early March. James sees it doubling in 12 to 18 months. He figures the company will earn 60¢ a share in 2003 on sales of $154 million and 72¢ in 2004 on $170 million, vs. 2002's 47¢ on $130 million. Money manager François Parenteau of Defiance Fund, which owns shares, says Inter Parfums' appeal is its earnings-grow dictability—up 30% a year. It's a simple, low-cost, hig itability business that's easy to track, says Parenteau.

BusinessWeek online Gene Marcial's Inside Wall Street is poste nessweek.com/today.htm at 5 p.m on the zine's publication day, usually Thursdays. In some holiday weeks, such as July date is a Wednesday. See Gene on Fridays at 1:40 p.m. EST on CNNfn's *The Mone*

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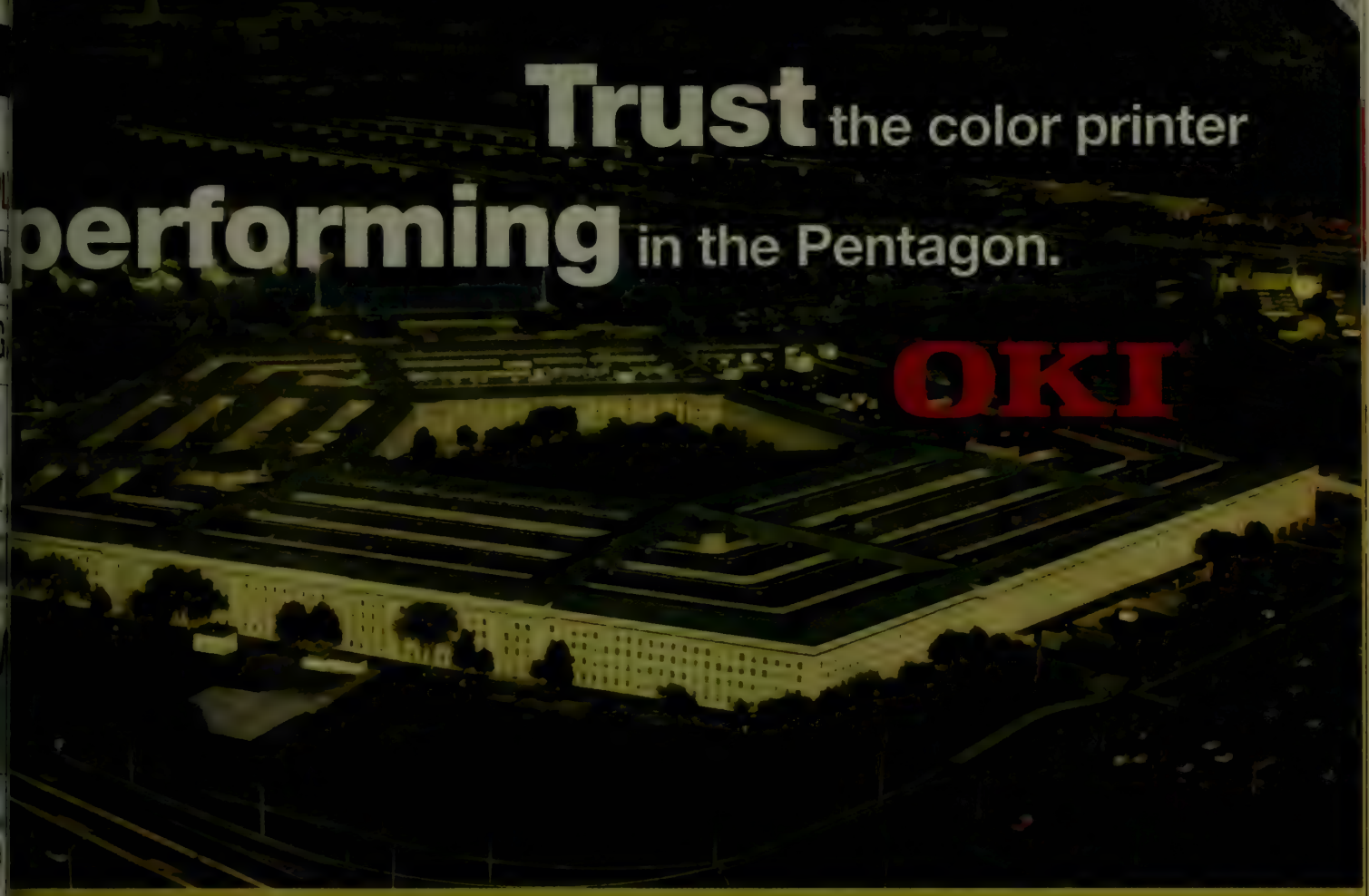

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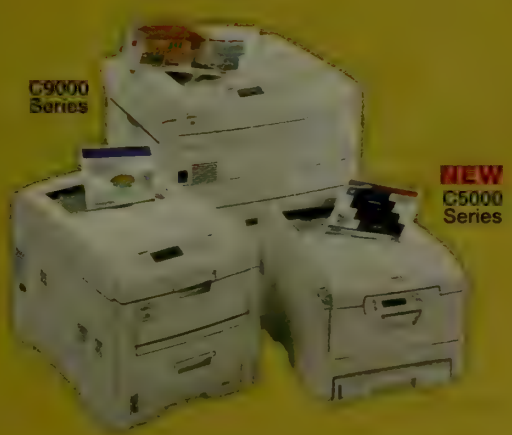

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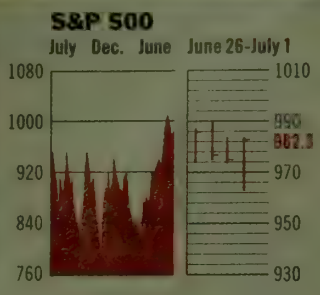
BusinessWeek Investor FIGURES OF THE WEEK

STOCKS



COMMENTARY

Stocks stumbled briefly on July 1 after a weak manufacturing report and downbeat construction numbers. But investors soon regained their composure and sent equities higher, helped by the Fed's promise to keep rates low. The true test, however, will come as companies report their latest earnings' results. For the week, the markets stayed in the black.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	JULY 1	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	982.3	0.7	11.7	1.4
Dow Jones Industrials	9041.0	0.3	8.4	–0.8
NASDAQ Composite	1640.1	2.3	22.8	16.8
S&P MidCap 400	482.8	0.8	12.3	1.0
S&P SmallCap 600	221.6	1.6	12.7	–1.8
Wilshire 5000	9409.9	0.8	12.8	2.6
SECTORS				
BusinessWeek 50*	584.1	0.6	7.7	–1.1
BW Info Tech 100**	309.5	1.9	8.4	7.4
S&P/BARRA Growth	500.2	0.9	11.4	4.0
S&P/BARRA Value	478.8	0.6	11.9	–1.2
S&P Energy	195.4	–1.3	6.7	–9.7
S&P Financials	334.4	0.8	12.6	0.9
S&P REIT	100.8	1.6	11.0	–0.8
S&P Transportation	177.7	2.0	4.6	–10.2
S&P Utilities	111.8	–0.5	14.4	–7.2
GSTI Internet	124.9	5.4	67.3	83.8
PSE Technology	567.2	1.4	23.8	16.7

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JULY 1	WEEK	% C YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	924.0	–3.5	9.
London (FT-SE 100)	3963.9	–2.6	0.
Paris (CAC 40)	3013.0	–3.1	–1.
Frankfurt (DAX)	3146.6	–1.6	8
Tokyo (NIKKEI 225)	9278.5	3.9	8.
Hong Kong (Hang Seng)	9577.1	–0.5	2.
Toronto (S&P/TSX Composite)	6983.1	0.2	5.
Mexico City (IPC)	7123.5	0.6	15.

FUNDAMENTALS	JUNE 30	WK. AGO
S&P 500 Dividend Yield	1.66%	1.65%
S&P 500 P/E Ratio (Trailing 12 mos.)	31.6	32.0
S&P 500 P/E Ratio (Next 12 mos.)*	17.0	17.3
First Call Earnings Revision*	–0.60%	–0.69%

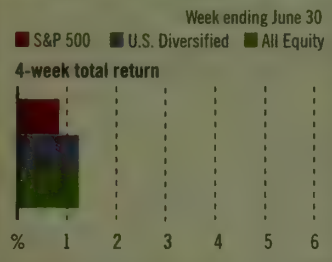
*Fir

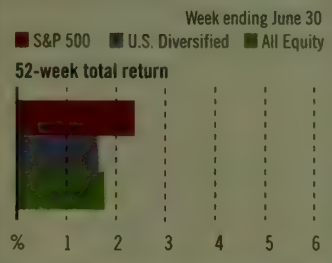
TECHNICAL INDICATORS	JUNE 30	WK. AGO
S&P 500 200-day average	892.7	891.2
Stocks above 200-day average	84.0%	80.0%
Options: Put/call ratio	0.78	0.70
Insiders: Vickers NYSE Sell/buy ratio	4.15	4.11

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Wireless Services	16.9	Internet Software	146.8
Computer Stores	13.2	Wireless Services	99.0
Internet Software	12.7	Biotechnology	65.3
Gold Mining	12.4	Office Electronics	55.8
Health-Care Services	12.3	Comptr. Stge. & Perphs.	45.9

WORST-PERFORMING GROUPS	LAST MONTH %	LA MO
Photographic Products	–10.7	Tires & Rubber
Health-Care Facilities	–9.4	Health-Care Facilities
Oil & Gas Drilling	–8.8	Automobiles
Motorcycles	–6.5	Multi-Utilities
Home Furnishings	–6.3	Steel

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Japan	5.9	Communications	21.7
Diversified Pacific/Asia	4.2	Health	15.6
Diversified Emerg. Mkts.	4.2	Technology	14.0
Pacific/Asia ex-Japan	3.7	Latin America	10.6
LAGGARDS		**LAGGARDS**	
Natural Resources	–1.5	Japan	–15.3
Europe	–0.5	Diversified Pacific/Asia	–8.9
Financial	–0.2	Foreign	–7.0
Utilities	0.3	Europe	–4.8

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Apex Mid Cap Growth	17.4	Jacob Internet	95.2
PFds. Wriss. Ult. Serv.	17.1	Fidelity Adv. Lvgd. Co. A	82.0
American Heritage	16.7	Amerindo Technology D	78.5
Eaton Vce. Grtr. India B	13.7	PFds. Biotech Ult. Inv.	63.5
LAGGARDS		**LAGGARDS**	
Rainbow	–9.2	Frontier Equity	–68.4
J&B Sm. Cap Intl.	–8.1	PFds. UltSh. OTC Inv.	–55.5
Fidelity Sel. Egy. Serv.	–6.8	Rydex Dynam. Vent. 100	–55.5
Rydex Energy Svcs. Inv.	–5.5	PFunds. Ultra Japan Inv.	–31.9

INTEREST RATES

KEY RATES

	JULY 1	WEEK AGO	Y
MONEY MARKET FUNDS	0.70%	0.72%	
90-DAY TREASURY BILLS	0.88	0.91	
2-YEAR TREASURY NOTES	1.30	1.29	
10-YEAR TREASURY NOTES	3.55	3.41	
30-YEAR TREASURY BONDS	4.59	4.46	
30-YEAR FIXED MORTGAGE †	5.27	5.24	

†BanxQuo

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR BOND	30
GENERAL OBLIGATIONS	3.32%	
TAXABLE EQUIVALENT	4.74	
INSURED REVENUE BONDS	3.43	
TAXABLE EQUIVALENT	4.90	

THE WEEK AHEAD

INSTALLMENT CREDIT *Tuesday, July 8, 3 p.m. EDT* ▶ Consumers are forecast to have tacked on an additional $5.6 billion of debt during May, following a $10.7 billion jump in April. That's according to the median forecast of economists surveyed by MMS International.

EXPORT-IMPORT PRICES *Thursday, July 10, 8:30 a.m. EDT* ▶ Export prices probably increased 0.1% in June, and import prices most likely rose 0.3%. A weaker dollar and firmer oil prices have halted the primarily energy-driven declines in import prices seen in the previous two months. During May, import prices declined 0.3%, while export prices inched up 0.1%.

INTERNATIONAL TRADE *Friday, July 11, 8:30 a.m. EDT* ▶ The foreign trade deficit probably widened to $42.3 billion in May. Both exports and imports are expected to have risen, with imports posting a larger gain. During April, the trade gap declined to $42 billion.

PRODUCER PRICE INDEX *Friday, July 11, 8:30 a.m. EDT* ▶ Producer prices very likely inched up 0.1% in June, after slipping 0.3% in May. Excluding food and e prices probably rose by 0.1% for a ond straight month.

The BusinessWeek production index move 195.4 in the week ended June 21, up 3% a year ago. Before calculation of the four moving average, the index slipped to 195

BusinessWeek online

For the BW50, more investment data, and components of the production index vis **www.businessweek.com/magazine/ext**

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BLACK PROGRESS: TWO WAYS TO LOOK AT IT

A deep philosophical divide exists between those who measure socioeconomic progress by mobility or by equality, by moving up from absolute poverty or by closing the relative gap between rich and poor. Nowhere is this divide more evident than in the discussion over the economic progress of African Americans in the '90s (page 100). The data provide evidence for both sides of the argument. There has been a remarkable reduction in black poverty over the past decade—yet there has been a surprising failure to close the economic gap between blacks and whites during that time. Whether the glass is half full or half empty, however, may well depend on where in society it is viewed.

At the bottom economic rung, people are likely to dream of moving up and out—and that's exactly what happened. The share of black families living below the poverty line dropped, from 31% in 1992 (roughly the level it had bounced around since the 1960s) to 21% in 2001. Average black life expectancy also rose, wages went up, homeownership increased, wealth expanded, and the percentage of young people completing college jumped significantly. Seen from the streets and ghettos of any American city, this represents huge progress for blacks.

The view from the perspective of the African American middle class may be different. There, where people consider equality a more important measure of progress, the glass appears half empty. There are more black executives and r agers in Corporate America, yet they earn much less their white counterparts. Black men still earn only 74 the median full-time wages and salaries of white m barely above the 1992 level. The relative earnings of b women have actually worsened. In 2001, the average worth of black families was 16% of white families, d from 22% in 1992.

Does this gap reflect some racial prejudice in Ame Probably so. But it is also true that the fast growth wealth generation of the '90s widened the gap between very rich and all other groups in the U.S.—whatever t ethnicity. It is also true that people of any color breaking managerial and professional ranks for the first time are va less by the marketplace than more experienced manag Hence the gaps in income and wealth.

For much of its history, the U.S. has been a place of socioeconomic mobility for African Americans and grea equality. In the '90s, this changed, thanks to fast gr and greater opportunities. Poverty was sharply reduced, millions of people rose into the middle class. An economic clearly remains, but the most important African American ry of the 1990s is the narrative of success and mobility. the story of the glass being half full and still rising.

HOLLYWOOD'S DIGITAL FUTURE

Few industries have failed so dismally to adopt to technological change as music. Digital file-sharing à la Napster eviscerated its traditional business model as customers pirated songs off the Web. And music's response? Sue its own customers. The spread of broadband now threatens Hollywood in much the same way, as pirated films begin to make their way to the Net. Hollywood's response? Learning from music's mistakes, the industry is beginning to use digital technology to deliver movies and TV shows on demand to the home as well as to a host of gizmos carried by today's urban nomads. But with some 600,000 copies of films illegally downloaded daily, Hollywood should move even more quickly. Smart kids with fast computers are subverting the industry's business model with each passing hour (page 74).

Ego-driven Hollywood isn't used to partnering with other industries, but this time it must. It has to make key decisions on fair use and pricing in the months ahead with consumer-electronics companies, cable operators, and the tech industry. Today, Hollywood sells the same product via different distribution channels in a controlled way. Studios release movies to theaters first. Six months later, they come out on video; six months after that, premium cable. Cash flows predictably. Earnings are considerable. Digital piracy compresses this time frame, undermining the traditional distribution system.

When this happened to music, the industry choked. seltown is being more nimble. Five Hollywood studios b offering movies last November. Others are following Hollywood is also choosing the pricing that consumers fer: per song or per flick, rather than the monthly scription the music companies pushed. Hollywood is ta Apple Computer Inc.'s iTunes Music Stores as a model. ple sells songs from many labels for 99¢, allowing custo to make copies but not send them to the Net.

Hollywood worked with the cable and consumer-electr industry on a proposal given to the Federal Commu tions Commission to allow customers receiving digital and satellite service to make unlimited copies of broadca shows, one copy of a cable show, and one copy of a pay view movie burned on a DVD. But Hollywood is at odds consumer electronics and high-tech manufacturers wh comes to analog TVs, PCs, handheld computers, and digital devices. Here, the studios are trying to tightly co their entertainment product—just like the music ind tried to do and failed.

Hollywood is writing its own script for the future. right, it could be a surprise box-office hit, like *My Bi Greek Wedding*. Done wrong, it could be a disastrous flo member *Ishtar*?

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AL REPORT

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THE MOST POWERFUL TRADER on WALL ST. YOU'VE NEVER HEARD OF

Meet Steve Cohen. He's the hottest hedge fund player around, routinely trouncing the stock market with his $4 billion fund. How does he do it?

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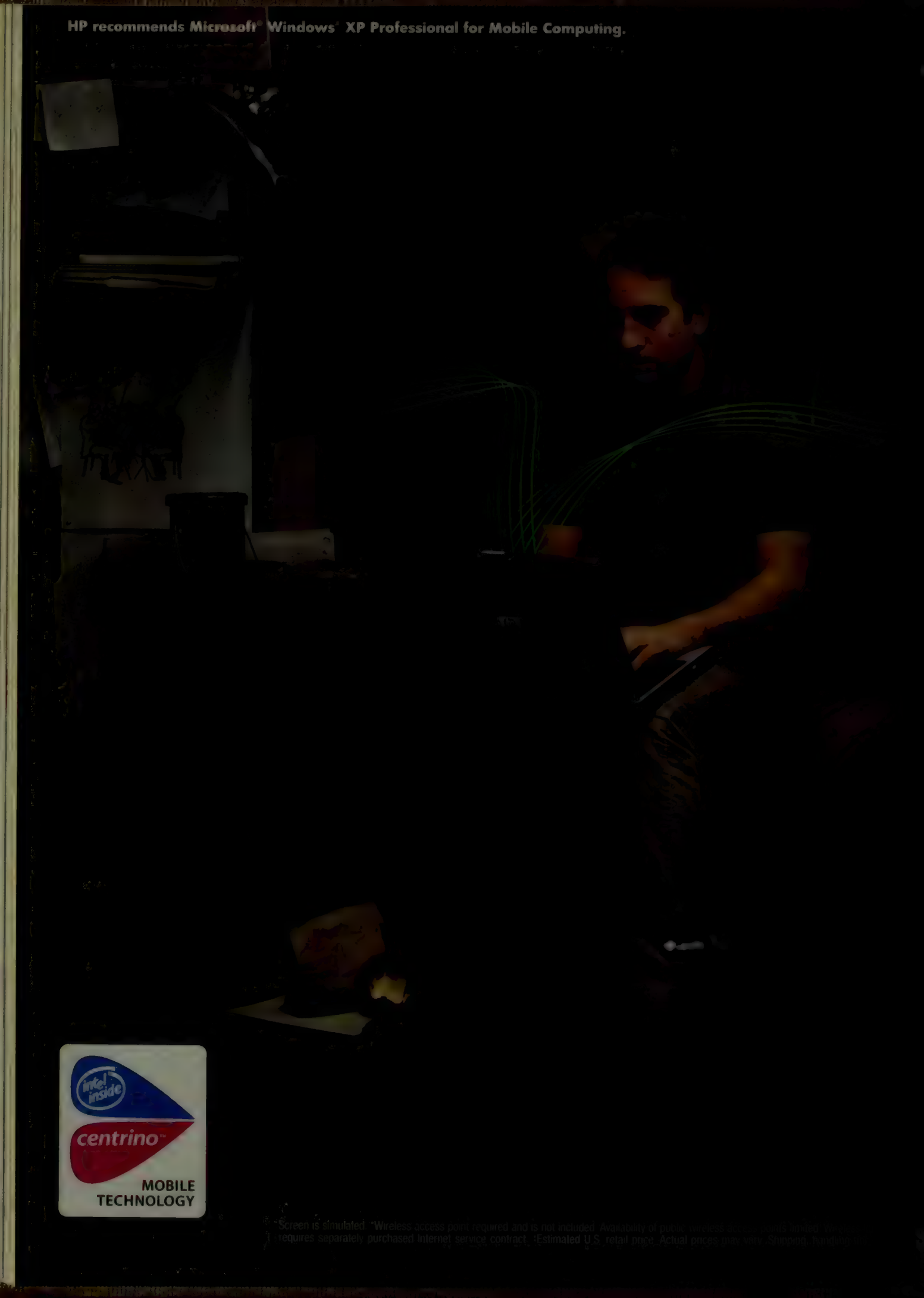

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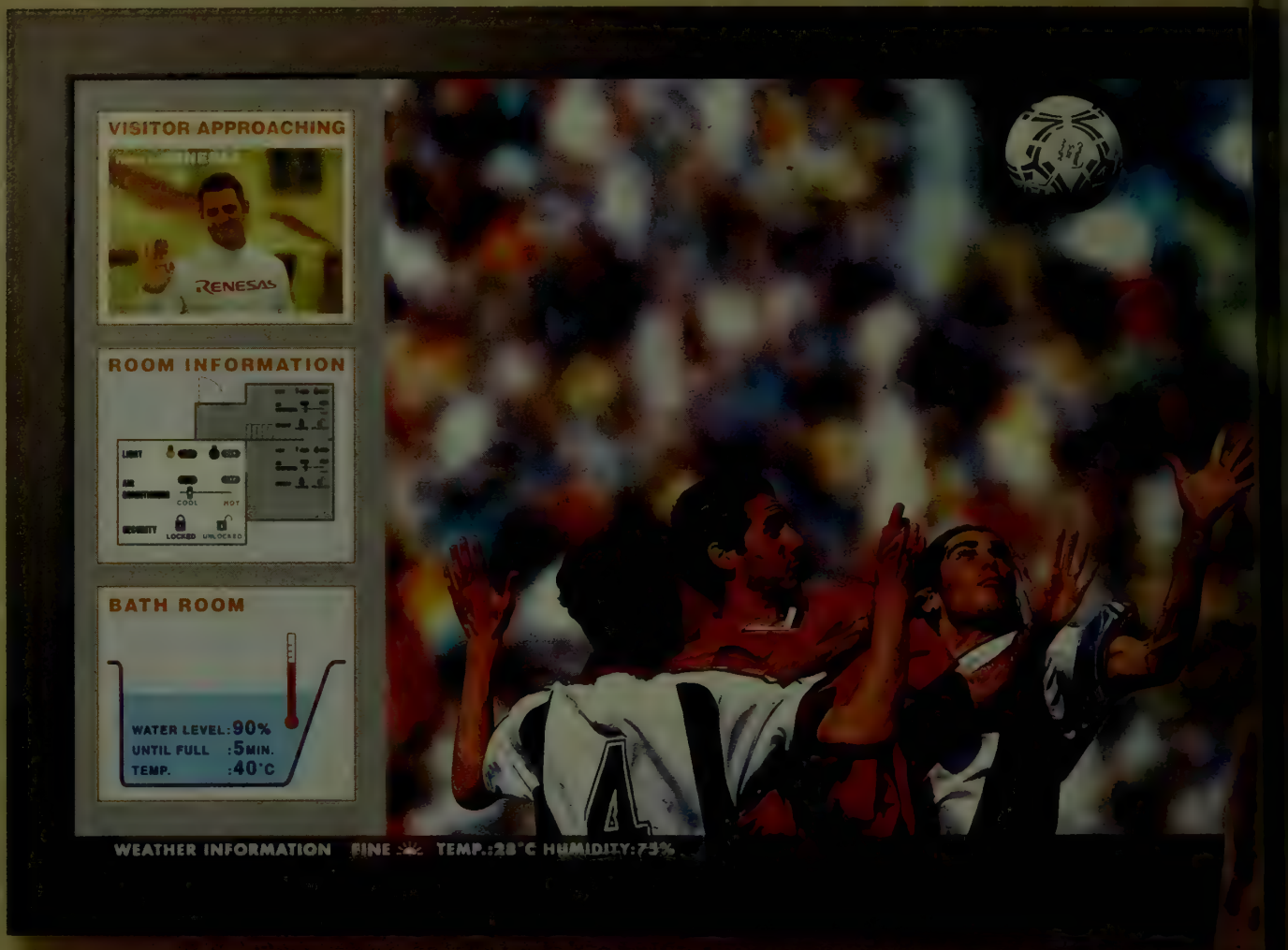

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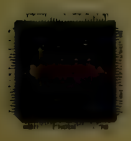

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STEVE'S WORLD
Cohen's runaway success has bought him the good life in Connecticut—though friends say money is just a "scoreboard" to him
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Steven Cohen of SAC Capital Advisors—a highly secretive $4 billion group of hedge funds—is considered a market genius by even his critics. Cohen manages less money than hedge-fund titans such as George Soros or Julian Robertson did at the height of their power, but his trading prowess leaves them in the dust. Here's how Cohen's hedge funds routinely trounce the market

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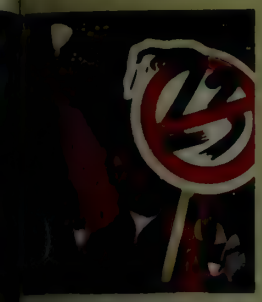

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Web services, the movement enabling disparate computer systems to communicate easily, isn't exploding, but rather gaining in fits and starts. This special report examines the impact

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Up Front

EDITED BY
IRA SAGER

Animals (PETA) sued Yum! Brands on July 7, alleging its KFC unit is lying when it says suppliers raise and slaughter chickens humanely. PETA sued Louisville-based Yum in Los Angeles under California's Business & Professions Code, which prohibits "unlawful, unfair or fraudulent" business acts. Nike also is being sued under the statute, about working conditions at its overseas suppliers. And Yahoo! recently settled a case over the handling of a Web user's personal information.

Plaintiffs suing under the statute don't have to live in California or show they were victimized. Attorney William Stern of San Francisco law firm Severson & Werson says cases dismissed elsewhere are being refiled in California. "The state's becoming the Havana of consumer litigation," he says. Perhaps the Golden State should consider adopting a new motto: caveat vendor. *Michael Arndt*

LITIGATION NATION

A GOLDEN STATE FOR LAWSUITS

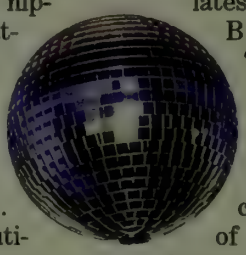
THOSE HOODWINKED BY ADvertising once had just two options: Complain to the Federal Trade Commission or the state attorney general. Then wait to see if they take action. No longer.

To the alarm of corporations, crusaders have found that a California law allows almost anyone—not just a government agency—to sue over false or misleading ads. And boy, are they ever. The most recent case: People for the Ethical Treatment of

CASINO SOCIETY

VEGAS, THE ACE OF CLUBS

FORGET FADED LOUNGE ACTS crooning in smoky rooms. Las Vegas' decade-long effort to reinvent itself as a hipper place is translating into a nightclub-building boom.



This month, the $6 million Ice lounge will open just off the Strip. The young and beautiful already wait hours to get into Light, a disco at the Bellagio, and Ghost Bar, a club atop the Palms Hotel. In February, the $7 million Tabu Ultra Lounge opened at the MGM Grand.

The nightclubs are a way to lure younger gamblers. But it's not all about casinos: The clubs make money, too. An espresso martini garnished with biscotti will set you back $15 at the Bellagio's latest club, the Caramel Bar & Lounge. "Nightclubs are valid investments," says Ice promoter Michael Fuller.

For those who crave the Vegas of old, velvet-voiced lounge reliable Lou Rawls sang at the May opening of OPM, an Asia-inspired club at the Caesar's Forum Shops. Some things never change. *Christopher Palmeri*

TALK SHOW "We know the Germans well—these ster typed hypernationalistic blondes....They noisily invade beaches." *—Italian tourism minister Stefano Stefani, in a l an Italian newspaper. German Prime Minister Gerhard Schröd promptly canceled a family vacation to Italy*

WILD BLUE YONDER

MIGHTY PRICEY CON AIR

EVEN AS THE AIR FORCE fends off criticism that it did not put a $19.6 billion aircraft lease deal out to bid, a similar arrangement at the U.S. Marshals Service is drawing scrutiny. Prompted by complaints from aviation execs, in June the General Accounting Office forced the agency to reopen bids on leasing six aircraft to transport prisoners.

Critics say the Marshals Service could have put taxpayers on the hook for millions of dollars in needless costs by limiting competitive bids. The agency had said it would consider only Boeing 737s, though its own consultants noted that other jets could do the job.

Leasing execs also slam the agency for assuming that renewable, one-year leases would cost less than a 10-year lease. Marshals Service spokesman Dave Sacks that bargains on on leases can be had in thi economy. But an earli the agency sought al yearly leases and came $30 million a year—25% than the agency had p ed. "A one-year deal d make any sense," says Hunter, president of V1 tion. He says retrofitting can run up to $1 m which can be recoupe over the long term. An could save taxpayer mo *Lorraine W*

737s: *The choice of marshals*

THE LIST **WATER—NEW AND IMPROVED**

Bottled water is now the fifth most popular beverage, b it's expected to rise to second by the end of the year, according to consultants Beverage Marketing Corp. Hop to cash in on water's growing cachet, here are some no additions to the $7.7 billion bottled-water market:

BEVERAGE	WHAT'S INSIDE
DNA ALCOHOLIC FRUIT AND SPRING WATER $5.99/6-pack	Carbonated spring water has 5% alcohol content from fr wine ingredient
GLACEAU VITAMINWATER $1.49/bottle	Vitamins, electrolytes, and additives such as St. John's Wort, calcium, or ginseng i different varieties
CLEARLY CANADIAN OXYGEN ENHANCED WATER $.99-$1.09/bottle	Up to 10 times the oxygen content of regular water, fruit flavoring
REEBOK FITNESS WATER $1.29/bottle	Four vitamins, three mineral electrolytes, fruit flavoring
SKINCOLA $2.25/bottle	Added oxygen with trace amounts of 16 minerals
WATER JOE $.99/bottle	As much caffeine as a cup of coffee

CONTRIBUTED BY KEVIN JOY

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Up Front

FINANCIAL SERVICES

I LOVE YOU—BUT I'M LEAVING YOU

COMMON SENSE SAYS THAT satisfied customers should be loyal customers. That doesn't seem to be true when it comes to financial services.

A survey of 767 corporate executives that buy insurance or finance services—such as pensions or health insurance—shows a gulf between satisfaction and loyalty. Some 75% of execs said they were happy with their supplier, but almost as many—66%—were planning to find a new one or simply end the relationship. While the execs describe themselves as pleased with their supplier, they still suspected they could do better. "Unless firms focus on customer service and personal relationships, even satisfied customers could easily leave," says Marc Drizin, with surveyor Walker Information.

Other clues to client wanderlust: Just 49% of execs thought their providers were highly ethical, and only 28% thought their suppliers treated their own employees well.

Execs in the finance industry are shopping around, too. Only 45% said they were loyal to their providers. Even among their own, financial-services companies face a tough sell. *Pallavi Gogoi*

TRAVEL LOG

THE EURO-TOURISTS ARE TRICKLING BACK

EUROPE'S TRAVEL INDUSTRY IS pulling out of its slump, even as American travel to Europe stays in the doldrums.

The signs of an uptick are tentative but promising. Lufthansa saw a slight rise in passengers in May over last year. Travel company Thomas Cook says bookings are up 8% since major fighting ended in Iraq. Club Med eked out a first-half operating profit of $14 million, vs. a $5 million loss last year. And while June bookings for German travel company TUI were off 10.7% from a year ago, that beats May's 15.2% dip. Says TUI CEO Michael Frenzel: "I am absolutely convinced that the positive developments will continue." Europeans are taking trips postponed during the Iraq war, and a strong euro makes travel to the U.S. and Britain cheaper.

Some clouds remain. France's opposition to the Iraq war has kept some Americans away, says François Delahaye, director of luxury hotel Plaza Athénée Paris. He is planning a New York publicity tour to lure them back. Britain saw a 12% drop in U.S. arrivals in the first four months of 2003, possibly due to security concerns. But for now, European tourists are picking up the slack. *Jack Ewing*

DRAWN & QUARTERED

GENDER WATCH

WHERE EVERY NIGHT IS LADIES' NIGHT

WHAT'S HOT ON THE CLUB scene in Japan? Host clubs for women, which feature pretty boys in their 20s pouring women drinks, lighting their cigarettes, and hanging on their every word.

TOKYO: *Male host in action*

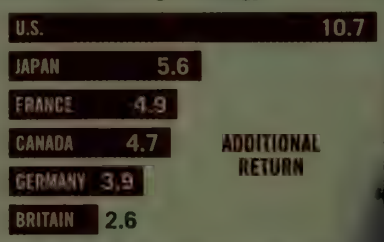
For years, Japanese men have visited hostess clubs where they are pampered by young women. But the number of host clubs—with names like Club Gigolo—has increased to over 100 in Tokyo, from about 30 four years ago, according to Ryo Hoshikawa, who runs a club promotion Web called fusionclub.net. clubs are "catering to d and wants, like eating," Shigeki Takahashi, the ager of Club Sugar, a club.

It's a phenomenon carries a certain iron Japan, w society dic that wo defer to in public. of the fe clientele, pay upw of $400 a to be sp get their ey from working as esses themselves. "It not usually happen that to be in the boss's s says one 22-year-old who gave her nam Sereka. *Sheridan P*

THE BIG PICTURE

GAMING THE SYSTEM

Think Wall Street analysts were all wrong? Traders buying recommended stocks after each upgrade and selling after each downgrade would have beat the market by as much as 11 percentage points. The results of this trading strategy in six countries:



*IN THE SIX MONTHS FOLLOWING EACH TRADE. TRADING COSTS NOT INCLUDED

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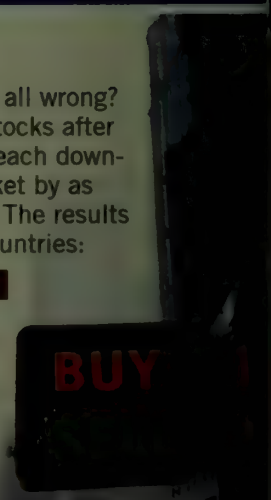

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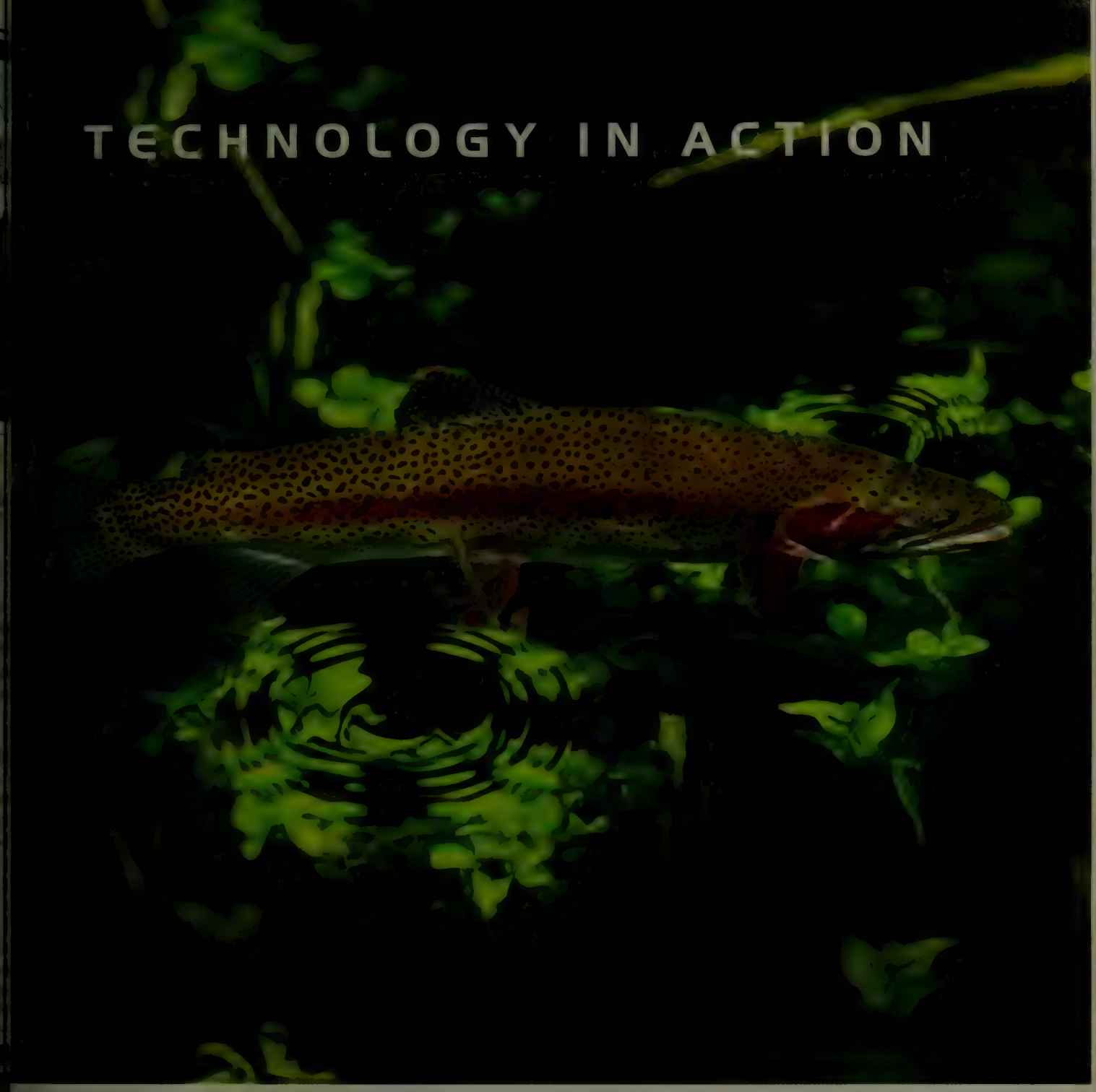

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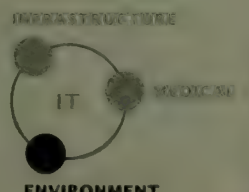

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Readers Report

IT'S NO BAILOUT, SAYS BOEING

"Inside Boeing's sweet deal" (Government, July 7), on the Air Force proposal to lease 100 Boeing KC-767 tankers, asks whether the leasing program is a "stealth bailout by the military or just smart business on both sides." It's no bailout and far more than just smart business. The program addresses an immediate need for the war fighter and brings clear value to the taxpayer. From the earliest stages, the Air Force and Boeing Co. have been entirely clear that there would be no lease unless it was in the best interests of the American taxpayer and fulfilled a pressing need of our military.

The current fleet of KC-135 tankers averages 43 years old, and the risk of a fleetwide grounding is growing. Each tanker is grounded more than one year out of five for expensive depot maintenance. Nearly 40% of the fleet is unavailable at any given time to provide critical in-flight refueling. Our men and women in uniform need to be able to rely on a fully capable tanker fleet.

The KC-767 lease program is an optimum way to meet that need. Boeing has already invested hundreds of millions of dollars to develop this modern aircraft, eliminating the need for a huge up-front government investment typical of other military procurements. Leasing KC-767 aircraft gets 100 essential aircraft to the war fighter five years sooner than a traditional procurement, under terms that all sides agree give clear value to the American taxpayer. That's no stealth bailout. That's meeting a national need.

Mary C. Foerster
Vice-President, Communications
Integrated Defense Systems
Boeing Co.
St. Louis

'FULL STEAM AHEAD' FOR ZOELLICK'S STRATEGY

Your story on the business comm ty's views on trade negotiations, "B free-trade diplomacy has Corpo America steaming" (Washington look, July 7), completely misrepres the Business Roundtable's views o Administration's trade policy. The ness Roundtable fully endorses Trade Representative Robert B. lick's competitive liberalization plan. U.S. was in the trade wilderness 10 years. And now, with the pas last year of Trade Promotion Auth Zoellick is pursuing the right strate negotiating bilateral and multila agreements.

As business executives engage trade around the world, we welc this aggressive approach to negoti trade agreements. Opening markets boost the economies of the U.S. and trading partners, and we believe bilateral and regional trade talks create momentum for the World T Organization talks. We're not "st ing," as *BusinessWeek*'s headline Instead, the CEOs of the Busi Roundtable say "full steam ahead U.S. trade negotiators.

John J. Caste
Presi
Business Roundt
Washin

VENDORS DON'T MAKE THE DECISIONS AT BORDERS

As for the role that vendors—s as publishers, record labels, and ers—play in working with Bor Group Inc. ("Selling books like bac Marketing, June 16), the vendors serve as lead suppliers do not make of the decisions regarding which t

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IRRECTIONS & CLARIFICATIONS

chart "The capital stock is shrinking," ich accompanied "Why the second half 't looking half bad," (Business Outlook, ie 16), was incorrect. The depreciation ta from the Federal Reserve measured preciation plus totals for capital con- mption adjustments. As a result, the ta overstated the amount of depreciation of the capital stock at nonfinancial porations. The exact numbers would w that the growth in the capital stock is wing, but the stock is not shrinking.

big bet on banking" (Up Front, July 7) ted that Robert Johnson purchased the arlotte Hornets, now named the Bobts. It should have said that Johnson ught an NBA expansion franchise in arlotte and named the team the Bobs. The Hornets moved to New Orleans.

carry in our stores or the way we note and merchandise the books. As ays, these decisions are made by ders.

Michael G. Spinozzi
Executive Vice-President
Borders Group Inc.
Ann Arbor, Mich.

THE IRAQIS OSE THEIR OWN LEADER

tan Crock's commentary, "How the . can keep Iraq from unraveling" ws: Analysis & Commentary, June ddresses the "most pressing tasks" focus on infrastructure, authority, resolve. Military action and target- in Iraq were limited to strikes in- led to neutralize a dictator and re- e him from power. There was no d to destroy the industrial or agri- ural capability of the nation in order ubdue it.

s one looks around in Iraq, it is y clear that most of the damage to ductive capability was green on en, caused by Iraqis looting other is. The combat forces of the U.S. here to help, and the Iraqi people grateful, but they do not wish to be ed aside in their own country. To do would be a mistake.

rock states that an all-controlling ign power governing Iraq is the answer to how to manage the is- here. His intentions are well placed fundamentally flawed. The point of presence here is not to replace their er with ours, but to allow the Iraqi le the freedom to choose their own er. If they choose wrong and fail, let them do so. As they say here, s Allah's will." Tough love is what rehabilitators call this approach, and that is what we need to do for Iraq: rehabilitate their government and country, not replace it.

Crock's description of living conditions in Baghdad is at best badly outdated. Baghdad is teeming with life. Stores are wide open and sell all that you need: fans, air-conditioning units, computers, televisions, DVDs, satellite dishes, and phones. Food markets abound. Bus and taxi services are all-encompassing. Electricity, water, and sanitation improve daily. Young children are in school, and the colleges took exams last week. Fire and police stations are open and functioning, backed by U.S. forces. Civil councils are established and meet daily with U.S. leaders to negotiate and prioritize civil work projects.

Finally, if there is anything keeping people locked in their homes, as Crock stated, it is the steadily increasing afternoon heat.

First Lieutenant John Turner
82nd Airborne Div.
U.S. Army
Baghdad

Editor's note: The writer has been deployed in Operation Iraqi Freedom since February.

A WINDFALL FOR UNCLE SAM, NOT THE ECONOMY

Because retirees have to pay income taxes on withdrawals from their tax-deferred individual retirement accounts, pension, and 401(k) accumulations, you suggest that such withdrawals, by reducing the government's need to borrow, will "free up more saving for business investment...[and thus] increase overall economic activity" ("A hidden stash?" News: Analysis & Commentary, June 30). But that ignores the implied reduction in private saving when retirees spend their aftertax accumulations on consumption.

The net effect of the cashing-in of such tax-deferred accumulations will be to reduce national (public plus private) saving and thus "crowd out" national investment. Consumption will be greater. Less capacity output will be available over all for business investment, infrastructure, and housing; for enhancing the skill and health of workers; for research that adds to usable knowledge; and for accumulating American-owned wealth abroad by way of a surplus of exports over imports. As a result, the economy's capacity to produce output for our own use will grow more slowly.

Francis Bator
Cambridge, Mass.

Editor's note: The writer is former deputy national security adviser to President Lyndon B. Johnson and is professor emeritus of political economy at Harvard University's John F. Kennedy School of Government.

A MORE RUGGED ROAD FOR MOTOWN CARMAKERS

"Can Motown get out of this funk?" (News: Analysis & Commentary, June 23) on U.S. carmakers' declining market share concluded that Motown's "road to recovery will keep getting steeper." A significant reason for this is the increased market share of Japanese auto makers—the longstanding beneficiaries of protection and huge trade imbalances with the U.S. Meanwhile, Japan's auto makers are comparatively free of the legacy costs and unionization that are facts of life at the Big Three.

American society cannot afford to lose its domestic auto manufacturing industry on this basis.

A. L. Dennison
Tempe, Ariz.

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THE LAST GOOD TIME
Skinny D'Amato, the Notorious 500 Club, and the Rise and Fall of Atlantic City
By Jonathan Van Meter
Crown • 296 pp • $25

AN EX-HOODLUM WITH THE KEY TO THE CITY

Imagine an astrophysicist who must explain the solar system to his students. He decides to do so not by examining grand theories involving planet formation or general relativity. Instead, he proposes a close examination of Mercury. Find out about this tiny, hot planet, and you will understand everything that matters, he tells his students. And rows of budding science wonks scratch their heads, look at each other, and wonder: Is that possible?

Well, this is the approach Jonathan Van Meter has taken in *The Last Good Time: Skinny D'Amato, the Notorious 500 Club, and the Rise and Fall of Atlantic City*. The author tells us everything we could want to know about a low-level hoodlum who, in the 1950s, rose to own the most glamorous nightclub in the most glamorous resort in America. And he uses that as a hook to examine Atlantic City's big issues: politics, crime, urban decline, and, of course, the impact of gambling. That's a large job to hang on the son of a Neapolitan barber—even if he did own the joint where Martin & Lewis got their act together and was the guy who told Joe DiMaggio that Marilyn was dead.

Van Meter, who has written for *Vanity Fair* and *The New Yorker*, doesn't quite pull it off, but he comes close. There are too many sections in this book that have to be plowed through rather than enjoyed—interviews that should have been summarized rather than quoted verbatim, long excerpts from official transcripts, and minor characters whose cameo appearances add little to the story. Even so, the myriad tales of mobsters, murders, dames, celebrities, and crooked pols provide persuasive evidence not only that you can learn a lot by studying the small, bright things in the universe but also that it can sometimes be fun.

Atlantic City's two big claims to fame right now are the delightfully anachronistic Miss America pageant, which began in 1921, and the legal casinos, the first of which arrived in 1978. Van Meter, however, deftly describes an earlier incarnation—a beach town whose fame rested on its status as Sodom and Gomorrah on the Atlantic. At the turn of the last century, soon after the railroads began bringing battalions of vacationing Philadelphia workers there, Atlantic City was chock-full of sleaze. Its panoply of bars, bordellos, and gambling dens made the resort both popular and prosperous. To many outsiders, the public face of Atlantic City may still be Miss America. But behind closed doors, Atlantic City was always a whore.

Prohibition only strengthened the grip of vice on the city's throat. Gangsters found the Jersey Shore an ideal place to unload bootleg liquor—so much so that between 1926 and 1933, an astounding 40% of all booze that entered the U.S. illegally came in via Atlantic City or its environs. This was possible, of course, only because organized crime was in bed with Atlantic City's notorious political machine and its boss, the all-powerful Enoch L. "Nucky" Johnson. He controlled the cops, helped elect senators, and didn't mind violating the 18th Amendment as long as he got his cut. Mob boss Lucky Luciano was happy to oblige.

In the midst of all this, Paul D'Amato, nicknamed Skinny, began his rise. Van Meter, whose interest in his story was sparked by an early job at *Atlantic City* magazine, seems to have interviewed virtually every surviving relative and friend of D'Amato to tell the tale of this avowed gambler who started running craps games as a kid. By 1946, D'Amato was on to bigger things and some pals had bought a strug restaurant with a backroom gam operation—the 500 Club.

In time, D'Amato learned from York saloonkeeper Toots Shor th coddling celebrities, he could attrac tomers who would pay to feel as w ly as those they ogled at nearby t "The 500 Club was ground zero fo supercool lifestyle," Van Meter w At the height of the club's fame i 1950s, Frank Sinatra played a re gig there, and DiMaggio had his booth. On any given night, you m see Elizabeth Taylor, Eartha Kitt, erace, or Milton Berle. And in sun when Skinny was in residence, t was always a discreet card game back room for the select few.

Even as the 500 Club was ascen to national prominence through the sip columns, the seeds downfall were being s Senator Estes Kefau 1951 televised hearing organized crime called a tion to D'Amato, who ha ways cavorted with g sters. He had long dre of having his own legal no. But in the early 1 when he and Sinatra tri run a small one in Ne his short fuse and mob nections led to their hasty exit. A Atlantic City slowly declined, D'A to's life took a sharp turn for the w His wife died, and his son pleaded g to a grisly murder. To top it off, 500 Club burned to the ground in

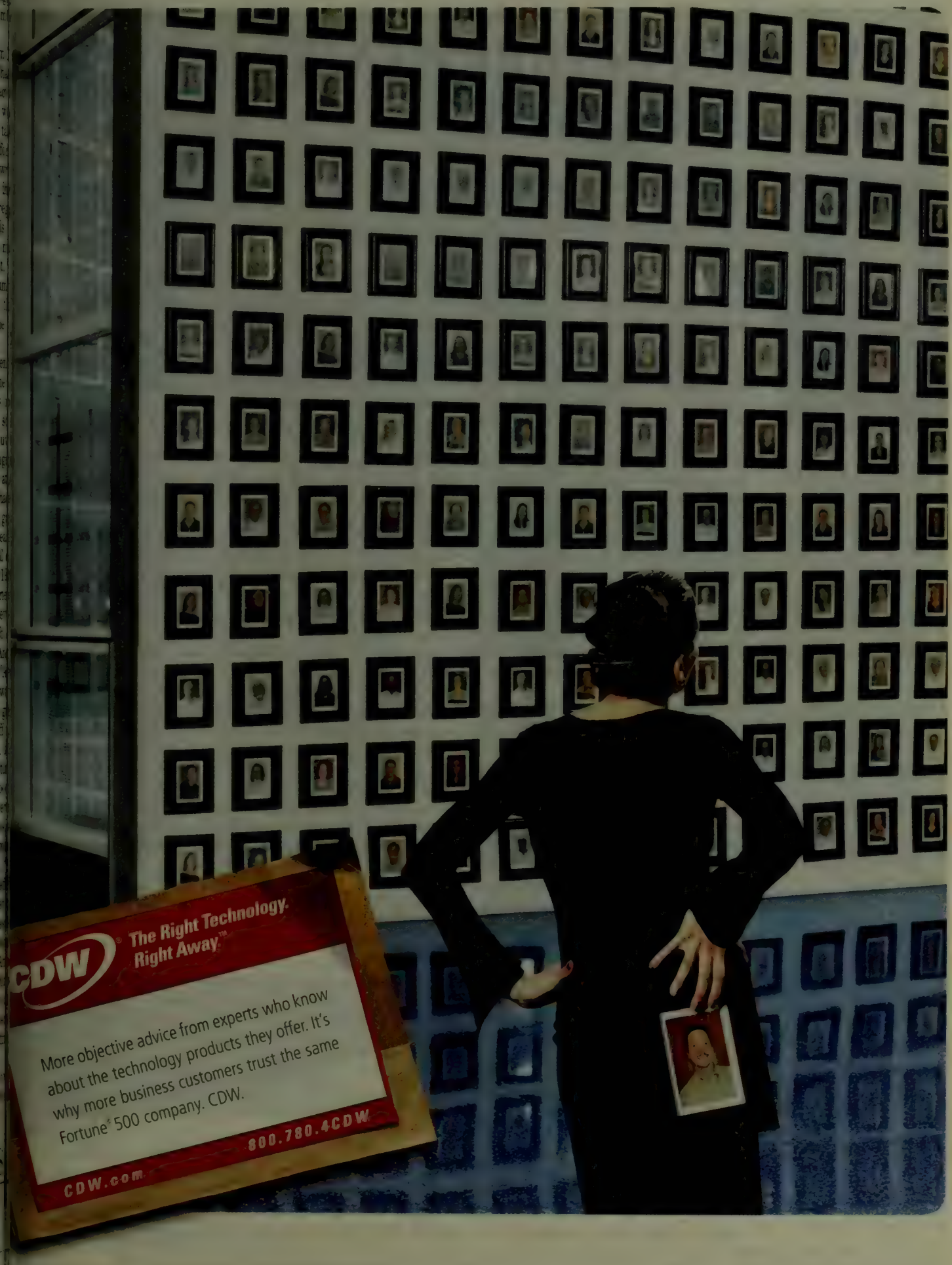
Today, away from its casinos, Atl City is still poor, perhaps even p than when D'Amato was born the 1908. There are now 12 casinos owned by corporations. The demim that spawned D'Amato is no more. lifestyle that Skinny seemed so ef lessly to embody is gone forever cause the apparatus that was neces to provide illegal gambling is no lo needed," writes Van Meter. D'A died in 1984, and the site of his cl now a parking garage for a Trump no. Odds are, D'Amato would e knowing that, in a small way, he fi got a piece of the action.

BY ROBERT Mc

McNatt writes about economic d opment and urban America.

D'AMATO FLOURISHED DURING ATLANTIC CITY'S DECADENT POSTWAR HEYDAY

pm. The addition of business customer number 360,001 creates a crisis for the Wall of Appreciation.



BY JEFFREY E. GARTEN

HOW CHINA IS THREATENING A GLOBAL RECOVERY

FREELOAD: Linked to the U.S. dollar, the yuan is falling. That hurts a struggling Europe and tilts the U.S. balance of trade

When you filter out the daily noise of international economic activity—stock market fluctuation, merger deals, trade disputes—today's most important trend is the decline of the dollar. Not long ago, the depreciating greenback would have been measured almost entirely against such currencies as the euro and the yen. But there is an important new guy on the block: the Chinese yuan. Beijing's failure to revalue it against the dollar is fast becoming an explosive global problem.

Since the mid-1990s, the U.S. has imported far more than it has exported. Recently, more capital has been flowing out than is coming in. This is producing a rapidly growing deficit in our international accounts. The upshot is that Uncle Sam is now relying on inflows of almost $4 billion of foreign capital each working day. The resulting debt not only is expensive but also puts the U.S. at the mercy of fickle overseas investors. If money from abroad started to dry up, the Fed would have to jack up interest rates to make investing in the U.S. more attractive, or the U.S. would have to slash consumption. These measures would hurt not only Americans but also other economies that are dependent on U.S. growth.

A gradual decline of the dollar is the least disruptive way for America to put its balance of payments on a more sustainable footing, but the dollar's descent still has a long way to go. C. Fred Bergsten, director of the Institute for International Economics, told Congress in late June that although the dollar has dropped against other currencies by 10% to 20% since early 2002, it's only halfway to where it should be. Yet for the decline to continue in an orderly way, other nations must allow market forces to work and let their currencies rise.

That's what is happening to the euro. Its value has increased some 20% to 30% vis-à-vis the dollar in the past year or so. But the same cannot be said of Japan, South Korea, or Taiwan, where there is ample evidence that central banks, in an effort to promote exports, have been suppressing the rise of their currencies by selling them for dollars.

An even bigger problem is China, where large trade surpluses and growing reserves should dictate a revaluation of the yuan. Nevertheless, the currency remains fixed to the dollar at a rate of 8.2 to 1. Every time the dollar notches down, the Chinese currency automatically follows suit, making that country's exports even more competitive. As long as the tight dollar-yuan linkage exists, other Asia tions won't allow their currencies to flo ward. They refuse to put themselves at petitive disadvantage.

Nearly all the burden of upward adjustm other currencies against the dollar has th en on the euro. European exports are be just as the Continent tries to expand ec growth. As John-Paul Betbeze, chief econo Crédit Lyonnais in Paris, told me, the s euro could throw the Continent into seri cession and cripple recent critical financial a cial reforms. A weakened Europe is a hug on global growth.

The obvious solution is for China to re its yuan. But China doesn't see it that wa cording to Nicholas R. Lardy, author of *grating China into the World Economy*. jing is worried that its trade surplus won It feels its currency reserves contain specu funds that could quickly reverse course jing also fears social upheaval that could with higher unemployment stemming fr decline in exports.

Nevertheless, Lardy believes that it behoove China to loosen the link betwe currency and the dollar, however slight does Fred Hu, managing director of Gol Sachs & Co. in Hong Kong. Both told me China's competitiveness ought to be ab withstand a more flexible currency pol agree, because I think China's comm prowess goes well beyond low prices. has enormous industriousness, a huge rese of talent, and a deep domestic market attr to foreign investors.

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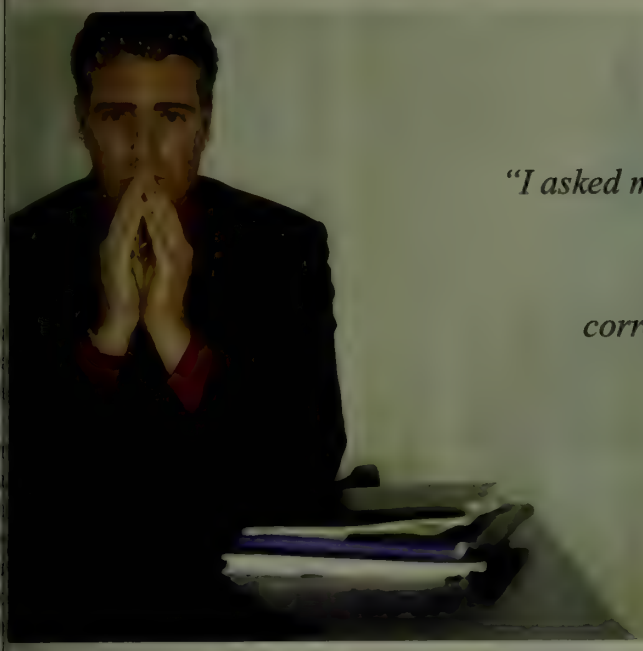
China should make a preemptive mov ward a more flexible currency. Other Washington and Europe could put excru ing pressure on the Middle Kingdom, cre serious tension in global markets and pr tating a political crisis between China an major trading partners. With an outcome that, everyone would lose.

Jeffrey E. Garten is dean of the Yale School of Management and author of *The Politics of Fortune: A New Agenda for Business Leaders* (jeffrey.garten@yale.edu).



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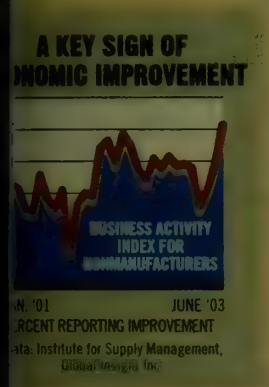
AMES C. COOPER & KATHLEEN MADIGAN

HE JOBLESS RECOVERY: EJA VU ALL OVER AGAIN

t unlike the early '90s, hiring now will take longer to turn around

U.S. ECONOMY The U.S. has been here before. Real gross domestic luct has been growing for more than a year, but nesses aren't hiring. The economy followed this after the 1990-91 recession. However, the cur- split between output and jobs is turning out to be e severe than the experience of a decade ago.



The June employment report made it clear that the labor markets are no longer treading water; by now they're drowning. Nonfarm payrolls shrank by 30,000 last month, on top of May's loss of 70,000, which had originally been put at a milder 17,000. The unemployment rate jumped to 6.4%, the highest rate in nine years.

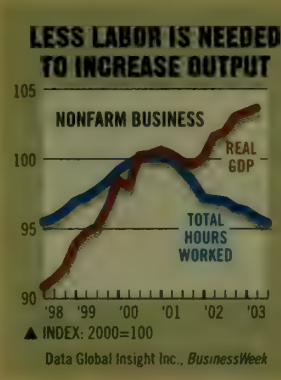
ontrast that dire news to the better reports coming n other sectors of the economy. In June, service in- ries had their busiest month since September, 2000 rt). Vehicle sales bounced back in June, as did oth- etail buying. In addition, tax cuts now showing up aychecks along with money freed up by mortgage ancings mean consumer demand can grow in the nd half, even as payrolls remain under water.

he financial markets are also in a "better times ad" mode. The Wilshire index of 5,000 stocks is up since March, and bond yields have moved higher raders see economic growth picking up and risks of ation shrinking away (page 20).

ll told, the second half is shaping up to be a time of rovement for profits, stock market prices, and the formance of output and demand. But it will be a y time for those seeking new jobs, at least until late this year. How quickly job growth picks up in 4 could determine the importance of the labor mar- s as a campaign issue in the Presidential election.

ALL THIS NEWS HAS a sense of déjà vu, it should. he early 1990s, the recession ended in March, 1991, businesses continued to cut jobs for months after- d. Nonfarm payrolls did not return to the pre-re- sion heights until the first quarter of 1993. If this iness cycle were following the same trend, then rolls should be expanding by now. They aren't—a ical reason why the National Bureau of Economic Research hasn't declared an end to the recession that began in March, 2001.

Today's job outlook is more onerous than the one of a decade ago. That's because businesses now are more intent on lifting output through productivity rather than with more labor. Since the fourth quarter of 2001, output has climbed steadily, while the total number of hours worked has fallen (chart). In the second quarter, real GDP probably grew at an annual rate of about 2%, while hours worked dropped by a 1.6% pace. That implies all of the gain in output was accounted for by a productivity increase, probably in the range of 3% to 3.5%.



The primacy of productivity runs counter to the lack of business spending on productivity-boosting equipment in this recovery. But companies are finding ways to use their existing capital stock more efficiently. As Federal Reserve Chairman Alan Greenspan has said, "Adjusting to new technologies takes time." Workers move up the learning curve, and their output per hour improves, allowing for gains in both profits and wages.

The downside is that their employers have little need to hire. The economy has lost 421,000 jobs since June, 2002, on top of the 1.7 million lost in the preceding year. Factories alone have laid off 639,000 in the past year, including 56,000 in June. But other industries are also shedding workers. Last month, airlines cut 7,200 slots; retailers let go of 12,800; and the struggling telecom sector laid off another 6,900 jobs.

WORSE STILL, the leading indicators for hiring were a mixed bag in June. On the plus side, temporary jobs rose by 37,700. That's evidence businesses are at least tentatively adding employees. As companies grow more assured about prospects, these temp slots will become permanent jobs. Another positive: The number of workers who could only find part-time positions fell for the second month in a row. That suggests more companies need full-time employees.

Offsetting those improving trends, however, is the fact that the average nonfarm workweek was unchanged at 33.7 hours for the third month in a row. Typically, businesses extend the hours of existing em-

ployees before hiring new ones. In addition, weekly new claims for unemployment benefits at the end of June remained above 400,000 for the 20th week in a row. Claims above 400,000 suggest payrolls are still shrinking, and that the July employment report will not change minds about labor-market conditions.

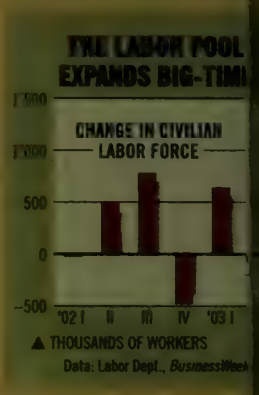
The dreary employment data are butting heads with the generally upbeat news on the economy. Sales of cars and light trucks rebounded to a 16.3 million annual rate last month, from 16 million in May. Weekly store surveys suggest other retail sales increased in June and that July buying got off to a good start.

Another boost: The Institute for Supply Management's index on business activity at nonmanufacturing industries jumped six points, to 60.6%, in June. The ISM reported gains in new orders and backlogs, prices, and employment.

The small rise in the June ISM employment index, to 50.3%, is consistent with the creation of 9,000 private service jobs. Since services account for two-thirds of all payrolls, they will lead any hiring turnaround. But back in the late 1990s, when service jobs grew by 200,000 and 300,000 a month, the ISM employment index was running in a range between 53% and 54%.

THE RECENT SPATE of good economic news seems to have turned around perceptions, if not the reality, of job prospects. The jump in the June unemployment rate was triggered in part by a rise in people rejoining labor force but who were unable to find work.

Keep in mind that in the fourth quarter of the labor force lost almost half a million people. kept the unemployment rate at 5.9% even though offs mounted. By this spring, jobseekers began po ing the pavements again. In the second quarter, th bor pool rose by 1.3 million, the biggest quarterly in three years (chart).



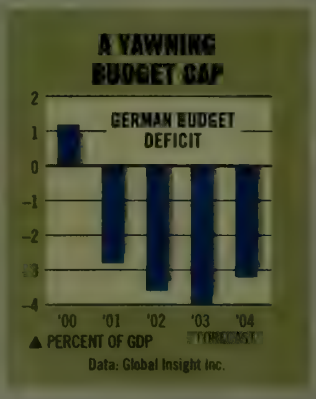
Much of the June increase in unemployment was the result of new entrants to the workforce, mostly graduates, and re-entrants, people who had given up looking but who started again with the hope that a strengthening economy would make jobs easier to find. Sadly, jobs aren't plentiful, and the days when employers offered signing bonuses and free massages to attract employees are long past.

Look for the Democrats to make the jobless reco an issue in the next election, since it's one area w the Bush Administration looks vulnerable. Unless nesses take a surprising turn and start hiring significant pace, this economy's lack of job growth remain a problem into 2004.

GERMANY

PUTTING THE STABILITY PACT IN PERIL

German Finance Minister Hans Eichel wants to cut income taxes by $23 billion in 2004 to kick-start the economy. He is hoping that accelerating tax cuts scheduled for 2005, on top of reductions already slated for next year, will start a virtuous circle whereby tax cuts stimulate growth and create more revenues.



Despite widespread expectations that Germany will breach the Stability & Growth Pact for a second straight year in 2003, Eichel says the tax cuts won't threaten efforts to keep the 2004 budget deficit below the 3% of gross domestic product limit. First, the government says the 2% growth it forecasts for 2004 will lead to an increase in tax revenues. Second, the government plans to trim spending and privatize some government holdings.

But there's a problem with Eichel's line: Only the government thinks growth will reach 2% in 2004. The German Institute for Economic Research says even with tax cuts, growth won't top 1.6%, after a 0.1% decline this year. That would lead Germany to break the Stability Pact again next year.

If Germany heads for a third straight breach of the deficit rule, it would very likely be publicly castigated by the European Union. Germany could also be fined, possibly making the budget situation even tougher.

A more serious consequence would be a loss of credibility fo the pact, ironically installed at Germany's behest. France and Italy could be tempted to follow Germany and let their deficits grow. Indeed, Germany's proble may widen the rift between larg and small euro zone members since countries like Finland, Ireland, and Luxembourg maintain more or less balanced budgets o surpluses.

Foreign-exchange analysts wa the pact is necessary to provide the euro with a credible budgetary foundation. The analysts say monetary union must be able to stop wayward government spen ing. If not, the creditworthiness other countries in the union will be called into question, leading t a deterioration in the currency.

By David Fairlamb in Frankf

Steve Galbraith, Morgan Stanley Chief Investment Officer

Fat tails thinning.

Stock return spreads go on a diet.

The market has been a relative disaster for three years now, and volatility indices remain somewhat elevated. And yet despite an environment where cats are chasing dogs, we are here to tell you that when it comes to individual stock returns, *fat tails are thinning.*

That's correct. Although we suspect it does not feel this way to most investors, the market has recently experienced a very significant liposuction operation. The wide return spreads or *fat-tailed* return distribution pattern for stocks we chronicled during the aftermath of the bubble has left the building, and there are several implications to draw from these thinning tails:

First, single-stock risk may be dissipating, suggesting fewer catastrophes ahead. Second, the opportunity set in long-short hedge portfolios has probably been winnowed massively. Third, while it seems wildly counter-intuitive given the extreme outcomes that could play out politically and economically, low returns and low volatility, not low returns and high volatility, could characterize the future.

Causes of fat tails — valuations as nutty as a fruitcake. Over the 1980 to 1996 period, the quintile of stocks with the highest price/book valuations traded within a relatively narrow range of around 4.0 multiple points above the cheapest quintile. At the height of the market frenzy, the quintile of most highly valued stocks traded at a staggering 21.1 point book multiple premium to the bottom quintile. Today, the spread between cheap and dear in the market is about 4.9 multiple points, in line with the average of the past 20-odd years.

With the advent of faceless Internet trading, individual investors could roll the dice without fear that someone might question whether margining one's portfolio up to the gills with Webvan was a prudent use of retirement dough. Well, roll folks did. Just as valuation spreads grew some 5 standard deviations above norms, so did margin debt. At its peak, margin debt reached almost 20% of total consumer credit. Since then, margin levels have returned within the realm of long-term norms.

Ga-ga growth expectations. Although it is difficult to justify the nonsense of the late '90s, there actually was an enormous increase in the spread of forecasts for long-term growth rates for the top and bottom quintile of stocks. As goofy as it seems, someone was actually forecasting that 200 companies would increase earnings almost 8 times nominal GDP (despite 100 years of history that suggest such an outcome was a virtual impossibility). Well today, we have moved from a mega-sigma event to…below average.

While it may indeed be better to burn out than to rust, a decent case is building that wide-return spreads or *fat tails* on stocks have already burned out and are now poised to rust. Although it may be too early to predict, if the biggest market boom and bust ends with a whimper while the world stage seems to be exploding with a bang, that could be the ultimate ironic ending to this manic era.

Steve Galbraith
Chief Investment Officer

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TAKING A CUE FROM INVESTORS

The market's bullishness is percolating into corporate suit

The financial markets smell economic recovery in the air. Share prices are soaring as investors bet on a second-half rebound of the economy, fueled by tax cuts and ultra-easy monetary policy. After rising by 15% in the second quarter, its best performance in 4½ years, the Standard & Poor's 500-stock index added to its gains as the new quarter began, rising a further 2.8% in early July. And the dollar is back in favor as foreign investors see the U.S. leading the way to global recovery. Even the tanking bond market reflects rising hopes for an economic upswing: Bond investors are shucking off their fears of deflation and fleeing the safety of low-yielding government securities for riskier equities.

The investor enthusiasm is starting to percolate into corporate suites. Encouraged by the ebullient stock market, CEOs are starting to shift their focus from fortifying their balance sheets to expanding their businesses. That bodes well for the recovery. It has been cautious corporate chieftains who have been mainly responsible for holding the economy back by keeping such a tight rein on investment and hiring. While th not yet partying like it's 1999, top utives are clearly feeling better. "T four, five weeks ago, we were ver spondent," says G. John Pizzey, p dent of aluminum maker Alcoa primary products group. "Now, we be headed in the right direction."

The positive signs are multipl Corporate confidence jumped in the ond quarter to its highest level year, according to a Conference B survey of 100 executives. Why? "T stock is up, and that puts them better mood," says Ken Goldstei economist with the business rese

Why the jump in executives' confidence? "Their stock is up, and that puts them in a better mood," says an economist

up. It's a spending mood. Capital ding, especially on information tech- gy equipment, is reviving. The mori- l mergers and acquisitions market come alive, with everyone from old- manufacturers to New Economy ware houses taking advantage of the p in the value of their shares to up other businesses. On July 8 e, three deals totaling nearly $4.5 n were launched. Even the scandal- ued market for initial public offer- is showing signs of life.

till, a robust turnaround is hardly a thing. The risk is that investors get carried away in their enthusi- . Share prices, especially for tech- gy companies, have already risen a page 22). A further price spike fol- ed by a sudden sell-off could spook orate CEOs, sending them scurrying k to their fox- s. In the bond ket, the global edive has already en up long-term rest rates sharply. he sell-off goes far, the rate hike d squelch the buoyant housing ket and puncture umer confidence, h is already a bit shaky because of increasing unemployment levels.

So far, though, the rise in rates hasn't hurt a bit. The main effect has been to drive investors to buy stocks instead of bonds. In July, net inflows to U.S. bond mutual funds slowed to about $1.9 billion a week from over $4 billion in March, according to strategist Thomas McManus of Banc of America Securities. At the same time, net investment inflows into U.S. stock funds are running about $2.6 billion—in contrast to the $2 billion-a-week outflow in March.

The reviving stock market is acting like a tonic for business executives. A June survey by Goldman, Sachs & Co. analysts found that 24% of information technology managers of big companies expect more tech spending in the second half of 2003. The message was much the same from a separate survey carried out by the National Association for Business Economics. Its roundup, released on July 8, found that capital spending rose in the second quarter for the first time in more than two years. And further increases are in store, partly because of stepped-up depreciation tax breaks that were recently passed by Congress. "We are seeing some signs of a recovery," says Daniel C. Ustian, CEO of Navistar International, the Warrenville (Ill.) manufacturer of big trucks and engines, which is now boosting production. The bad news: There's no break in the bleak job market, where unemployment rose to a nine-year high of 6.4% in June.

Perhaps nowhere has the bounce in the stock market had more of an effect on reviving corporate spirits than in M&A. On July 7, aluminum maker Alcan Inc. weighed in with a hostile cash-and-stock bid for rival Pechiney of France valued at $3.85 billion. That was followed the next day by a $2.2 billion bid by truck-axle manufacturer ArvinMeritor Inc. for Dana Corp., a $1.3 billion all-share bid by data storage maker EMC Corp. for corporate software provider Legato Systems, and a nearly $1 billion stock-and-cash offer by trucker Yellow Corp. for rival Roadway Corp. The flurry brought the total values of deals through the first eight days of the third quarter to nearly $21 billion, according to Thomson Financial. That compares with $93.4 billion for the entire second quarter and $70.1 billion in the first.

Encouraged by the rebound on Wall Street, a few executives are even daring to approach the market with initial public offerings. Fledgling companies raised $1.8 billion through IPOs in the second quarter, nearly triple the pace of the first. The revival has continued in July, with some $677 million worth of deals in the first eight days of the month alone.

But it's in the bond market where companies have raised the bulk of their financing. According to Moody's Investors Service, U.S. companies took advantage of the interest-rate bottom to issue $220 billion worth of bonds in the second quarter, up 20% from a year ago. Junk-bond issues alone soared by 61%, to $46.3 billion.

Sure, corporate-bond yields have risen with the gusher of new supply. But Moody's chief economist John Lonski points out that they're still historically low. The yield on 25-year industrial company bonds rated A stands at about 5.9%. Although that's above June's 5.6% average, it was way back in 1967 when rates were last at these levels.

The story is much the same in the housing market. Even with the recent reversal in yields, mortgage rates are near their lowest lev-

el in decades, at about 5½% for a 30-year loan. "Anything under 6% is terrific," says National Association of Home Builders chief economist David Seiders, who sees the housing market remaining buoyant this year.

What's more, Seiders expects any further rise in mortgage rates to lag behind Treasuries. Why? As rates rise, homeowners will be less likely to refinance their mortgages. That will make mortgage-backed bonds more attractive to investors, who won't have to worry about having their investment paid off early. In turn, that should reduce the 200-basis-point premium over Treasury rates that issuers of mortgage-backed bonds have had to pay, Seiders says.

There's no doubt, though, that the fading of the refi boom will take a bite out of the economy. For the past few years, homeowners have used successive rounds of refinancing to take tens of billions of dollars in equity out of their houses. All that cash has kept consumer spending strong even as the economy has struggled. This year, though, homeowners will cash out $20 billion to $30 billion less from refis than in 2002, says David A. Wyss, chief economist at Standard & Poor's, which, like *BusinessWeek*, is a unit of The McGraw-Hill Companies. But that shortfall will be mor offset by income-tax cuts just now ing up in workers' paychecks, he

Ever since the economy hit the in 2001, investors have been pining full-fledged economic upswing something has always happened t those hopes: the terrorist attacks tember 11, the scandals of Cor America, or the war in Iraq. Now more—investors are gearing up recovery. This time around they n nally be right.

By Rich Miller in Washingto David Henry in New York with M Arndt in Chicago

COMMENTARY

By Timothy J. Mullaney

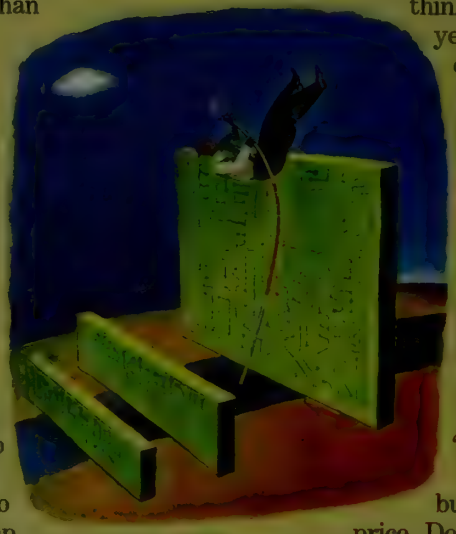
WHY THE TECH RALLY IS NO FREAK PERFORMANCE

That sound from Wall Street this week was the sharp snap of minds changing about technology stocks. The NASDAQ Composite Index average jumped 5% on July 7 and 8, to cross 1,700 for the first time since May, 2002. It's now up 31% for the year. The biggest catalyst was a survey of corporate technology buyers that Goldman, Sachs & Co. released on July 7, saying that tech spending will rise about 5% next year by Goldman's reckoning, the first gain since 2000. That may not sound like much, but consider the source: Goldman has been bearish on tech for two-plus years.

Is Wall Street getting carried away? Maybe, but not as much as it may seem. Tech companies have been beating their earnings estimates for the first time in two years. Renewed business confidence is raising hopes that CEOs may start spending again. And because info-tech companies have cut costs so drastically over the past three years, even a modest uptick in capital spending should fall straight to the bottom line.

Profit expectations are rising as fast as stock prices. The price-earnings ratio for the 80 tech stocks in the Standard & Poor's 500-stock index is 28, compared to 18 for the S&P 500. That's the same as it was in early January, despite a 21% gain in blue-chip tech stocks this year. That's possible because investors expect profits from early 2004 to be 20% higher than in early 2003.

The tech story has been slowly improving all year. Info-tech companies beat analysts' estimates in the first quarter, with earnings up 17% from early 2002. Second-quarter profits should grow 20%, says Thomson Financial First Call, rising to 29% for the whole year. Optimists also point to a 14% jump in June sales at bellwether chipmaker Taiwan Semiconductor Co., which may signal more PC demand.



More important, sentiment is improving in the corner office. Randell Moore, editor of newsletter *Blue Chip Economic Indicators* in Kansas City, Mo., predicts a 7.5% hike in capital spending next year, up from 1.1% in 2003. And on July 8, the National Association of Business Economists said spending on computers and telecom gear will be "significantly stronger than for overall capital spending."

Tech companies are lean enough make an earnings recovery on the slimmest uptick in demand. Tech's 17% first-quarter earnings gain was achieved with only a 2% rise in rev enue. Look at Hewlett-Packard Co. After $3.5 billion in cost cuts, analys think HP will triple last year's October quart earnings on only a 6% revenue gain. some point, though demand needs to pick up to keep th momentum going. "You really have t have that recovery in '04," says Bill Keithler, director sector investments at Invesco Funds Group in Denver. "We think we will."

This isn't a cue t buy everything at an price. Dot-com leaders eBay Inc. and Amazon.com Inc. are so pricey, even bulls counsel a cooling-o period. The doubling and tripling of share prices at weaker companies is riskier yet. Sun Microsystems Inc., even at $5 a share, trades at 50 time fiscal 2004's projected earnings.

Yet the market is doing what it's supposed to do—predict a recovery just before it arrives. As is always the case, some people won't believe it's real until companies move from talking about spending to actually whipping out the wallet But that's a natural con sequence of the disappointments of the last three years. Tech's long winter is finally drawin to a close.

With Ben Elgin and Jim Kerstetter in San Mateo, Calif.

BEHIND THE REBOUND

Investors are betting even a modest sales uptick will profit companies that have cut costs deeply

EXPECTED QUARTERLY PROFIT GAINS AT TECH COMPANIES IN THE S&P 500

Q2	Q3	Q4
20%	54%*	26%

*Third-quarter '02 profits were unusually low because of restructuring charges at Lucent Technologies Inc.

Data: Thomson Financial First Call

KPENSATION

VILL STOCK OPTIONS OSE THEIR SEX APPEAL?

licrosoft move and a FASB ruling may pressure techdom to give them short shrift

year ago, Microsoft Corp. Chief Executive Steven A. Ballmer was asked why the company didn't take a leadership role in reforming industry accounting. Why, an ana- asked, didn't the tech giant deduct ost of stock options from its earn- ? Ballmer's response: Others in the world say the fallout would be y, very gloomy." As a leader, Mi- oft stood by its industry.

o more. On July 8, Microsoft did unthinkable: It scrapped stock op- , eliminating a form of pay that e thousands of Microsoft employees onaires and helped define the cul- of the tech industry. Instead, start- n September, the company will pay 54,000 employees with restricted , a move that will let employees e money even if the company's e price declines. Like stock options, restricted stock will vest gradually a five-year period from the issue . Under accounting rules, grants of icted stock are counted as expens- nd charged against earnings.

icrosoft's explanation for the switch the "angst" it faced from employ- whose stock options were worthless. asked: Is there a smarter way to pensate our people, a way that would e them feel even more excited about financial deal at Microsoft and at same time be something that was at as good for the shareholders as to- s compensation package?" says ner

lore than just altering one compa- pay program, the move promises to ge forever a perk that is as closely d with technology as the assembly is with the auto business. "This ks the beginning of the end of the ons compensation era," says Robert Austrian, an analyst with Banc of erica Securities. Stock options paved dom with gold, making millionaires of top execs and rank-and-file soft- e programmers alike. But critics ar- that they distorted company earn- , camouflaging an expense that never showed up on the bottom line. In response, the Financial Accounting Standards Board is preparing a rule that would require expensing of stock options. Here's how Microsoft's move will affect employees, investors, and the tech industry.

WHAT DOES THIS MOVE SAY ABOUT MICROSOFT?

No company has been more of an icon of the tech boom over the past quarter-century than this software giant. But as the company nears its third decade, its financial performance has become staid. Sales, which climbed an average 36% a year through the 1990s, haven't cracked 16% growth this decade. In the 1990s, Microsoft shares grew nearly 100-fold, from a split-adjusted 60¢ to $59.19. Share prices have been halved since the 1999 peak. The new pay plan is a tacit admission that Microsoft isn't the growth stock it used to be. Microsoft shares haven't kept pace with others in the industry. Its stock is up 6.3% this year, compared with a 43.6% rise in the Merrill Lynch 100 Tech index.

"We believe, for us, this compensation is the right approach. It's not for everybody"

STEVEN A. BALLMER, *CEO of Microsoft, on why Microsoft switched from options to restricted stock*

WHAT DOES THE CHANGE MEAN FOR MICROSOFT EMPLOYEES?

The biggest shift is that employees can get some value from their stock even if the price doesn't climb. That may not seem like much of a motivational force. But with shares well off their 1999 high, virtually all the options granted since then are worthless. That means the 20,000 employees that joined Microsoft in the past three years have seen little or no benefit from their stock compensation. Now, employees will still have a strong incentive to improve the performance of the company and its stock price. But they don't have to wait for the gargantuan price jumps of the past decade—jumps that aren't likely to come from a mature company, anyway.

Their existing stock options won't be worthless, either. Under the new plan, which needs regulatory approval, employees can elect to sell their options to J.P. Morgan. In an e-mail to employees, Ballmer wrote that at a Microsoft stock price of $25, the company expects that options with a grant price ranging from $33 to $34 could be sold for ap-

proximately $1.80 to $2.10 each. Not much, but it's better than nothing.

WHAT IS THE EFFECT ON EARNINGS AND ACCOUNTING?

Microsoft will announce on July 17 the impact on its earnings. With its report for its first fiscal-year quarter ending in September, the company will begin to account for the expense of new stock awards and for stock options that are vesting. The hit from the fresh expense could be as much as 23% of earnings, according to analysts at Goldman, Sachs & Co., who looked at the cost of past Microsoft stock-option payments. But the company probably won't have to hand out as many dollars' worth of stock as it did of stock options in order to satisfy employees. If it can cut its costs for stock-based compensation by one-fourth, its newly reported expenses would be about 17% of earnings. Microsoft is choosing to account conservatively for the ongoing vesting of options it has granted in the past. That means the potential advantage of switching to stock awards will phase in gradually.

WHAT'S IN IT FOR MICROSOFT SHAREHOLDERS?

Investors aren't too rattled. The day after the announcement, Microsoft shares fell 23¢, or 0.8%, to $27.47 in a trading session in which the Dow Jones industrial average dropped 0.7%. Over the longer term, its stock price could go up, notes analyst David Bianco of brokerage UBS. Investors could be encouraged if Microsoft gets more output from employees because its stock compensation provides stronger incentives without extra cost. Plus, since Microsoft plans to hand out fewer restricted shares than it did stock options, it may not need to buy back as many shares, which could conserve cash and minimize dilution.

WHAT DOES MICROSOFT'S MOVE MEAN FOR OTHER TECH TITANS?

Intel Corp., Cisco Systems, and others have vowed to keep issuing options. They argue that there is no accurate way to account for options and it would be a disaster, they say, if tech companies had to expense them. Unlike Microsoft, most tech outfits face fierce competitors in the U.S. and overseas. They believe stock options are a good way to keep competition from poaching key employees. These are legitimate concerns, but Microsoft's move and the expected ruling from FASB mean it's probably only a matter of time before the day of reckoning comes for the rest of the industry. There's already momentum in that direction in all types of corporations. According to Mercer Human Resources Consulting Inc., a compensation consultancy, 220 companies have announced plans to expense options this year. And on July 9, Daimler-Chrysler AG revealed that it is considering scrapping stock options.

WON'T EXPENSING OF OPTIONS CRIMP INNOVATIVE STARTUPS?

Indeed it may. The FASB ruling will apply to private companies as well as public ones. Startups typically offer recruits generous grants of stock options because they can't afford the salaries that more established companies offer. They also say they need a come-on to convince talented people to give up secure positions and risk their careers on unproven companies. If these nesses have to expense stock optic may take longer for them to ac profitability, delaying an initial p offering and requiring them to additional venture-capital funds. mandatory expensing, "it will be hard to have a succe startup company in Silicor ley or in the U.S.," w Marc Benioff, CEO of S force.com Inc., a software pany that is expected t public next year. He ma overstating the case, but world that is increasingly tile to startups, any addit burden makes it even difficult for these innov to thrive.

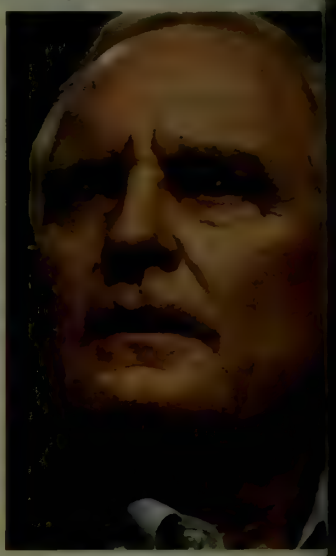
WHAT DOES THIS MEAN EXECUTIVE COMPENSATI

With Microsoft as their blazer, expect many other panies to reexamine their compe tion programs. Under the Micr plan, its top 600 executives and agers will receive most of their pensation in the form of restri stock. The amounts will depen growth in the company's customer and improved customer satisfac Many other businesses will likel persuaded by the Microsoft exa to replace some option grants with stricted stock. But no one expects tions to disappear entirely, what the cost. Compensation consultants that options—with their promise big payoff—will remain an import albeit smaller, part of the execu compensation landscape.

By Jay Greene in Seattle, with Edwards in San Mateo, Calif., Steve Hamm, David Henry, and L Lavelle in New York

> **"When a company gives something of value to its employees in return for their services, it is clearly a compensation expense"**
>
> **WARREN E. BUFFETT,** *chairman of Berkshire Hathaway, in a 2002* New York Times *op-ed article on expensing stock options*

> **"I think it's a threat to innovation and creativity in the U.S."**
>
> **CRAIG R. BARRETT,** *CEO of Intel, on the expensing of stock options*



WHICH IS BETTER—STOCK OR OPTIONS?

When the e-mail went out that there was to be a company-wide meeting on July 8 at 2 .m., few Microsoft Corp. employees new what was in store. Top management had carefully guarded the ct that Microsoft would halt its ock-option grants to employees in vor of restricted stock. Even managers weren't informed until half an our before Chief Executive Steve allmer's speech.

If Ballmer was afraid that employes would revolt at the demise of ne of the building blocks of Mi-osoft's culture and dominance, the rass needn't have worried. The edmond (Wash.) software maker's ank and file had been watching their ptions sink deeper under water for ne past three years. "Everyone I've lked to has said this is a better ning," says one Microsoft manager ho asked not to be named. "I o not believe Microsoft or companies in our genre will see the ame kind of growth [we had] efore and I don't think anyne at a gut level believes the tock price will go up like that gain."

While options once made licrosoft a storied place that inted millionaires, today any of Microsoft's 1.6 billion ptions are worthless. Without fast-appreciating stock, options cease to be much of a tool r retention or motivation. It's problem that a lot of companies are grappling with.

That means that plenty of lks are likely to face the same uestion Microsoft employees re mulling: Over the long erm, which is a better deal, tock or stock options? That deends on the performance of eir company's stock. If it lags r only grows at a modest rate, ey're better off with the tock. Usually workers get a ertain number of restricted hares provided they meet ome hurdle—often something s simple as staying with the ompany for the next three ears. At that point, they're ee to cash in their shares. So nless the stock has fallen to ero, the employee is ahead.

Options on the other hand are r riskier. They represent the right to buy the stock at a point in the future at a preset price, usually the price when the options are granted. If the stock climbs above that strike price, the worker is in the money. If it falls, he or she is in the same boat as the holders of all those worthless Microsoft options—nowhere.

Because options are riskier, they're usually valued lower than shares and given in greater numbers. According to compensation consultant Steven E. Hall, president of Pearl Meyer & Partners, an employee generally gets three to four stock options for every share of restricted stock.

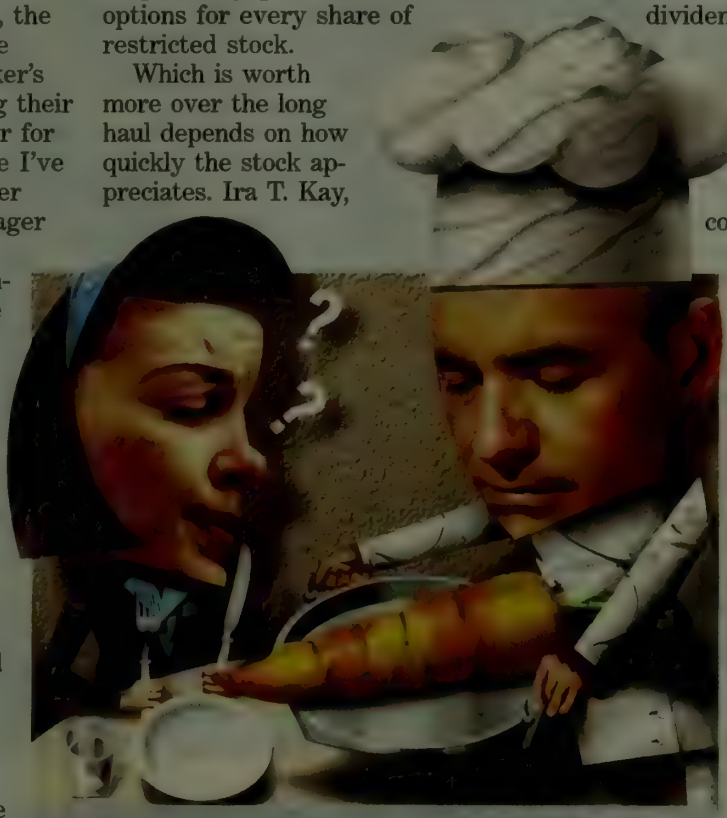
Which is worth more over the long haul depends on how quickly the stock appreciates. Ira T. Kay, director of the compensation practice at consultant Watson Wyatt Worldwide, says that the equalization point is usually around 10% to 15% annual appreciation. If your stock goes up more than that, you'd be better off with options. Otherwise, you'd be better off with restricted stock.

There are other factors to consider as well. At companies that pay big dividends, employees might do better with restricted shares because an amount equivalent to the dividend starts to accumulate from the day the shares are granted. With options, dividends kick in only if the option is exercised and the shares are held.

Restricted shares, however, are trickier when it comes to taxes. You can pay an income tax on them up front and then owe only capital-gains tax on the appreciation from that date forward. But you would forfeit that tax payment if the shares failed to vest—for example, if you left the company. Alternatively, you could pay Uncle Sam when the shares vest, but you'd lose the lower capital-gains rate on the appreciation.

Even in a tough market, many technology workers still want options. John Jennings, director of systems integration for Sun Microsystems Inc., says that stock options helped him finance a home in Silicon Valley, vacations, and his kids' college funds. "I work in high tech because it's a high-risk, high-reward business," says Jennings, who has been at Sun for 10 years. "If Sun didn't have stock options, I might be looking elsewhere." Time will tell if it's Sun's employees or Microsoft's who are on the right side of that bet.

By Nanette Byrnes in New York



HOW WOULD YOU LIKE YOUR CARROT?

The pluses and minuses of restricted stock vs. stock options:

ADVANTAGE OPTIONS

- **Upside** Since options are worthless initially, grants are usually larger, so the payoff on a hot stock is greater.
- **Taxes** The tax treatment is similar for restricted stock and stock options, but the tax bill on restricted stock can come due much sooner.

ADVANTAGE RESTRICTED STOCK

- **Downside Protection** Provided the stock doesn't go to zero, restricted stock keeps some value. Underwater stock options are worth nothing.
- **Dividends** Restricted stock carries dividend equivalents from day one. Stock options don't until they are exercised.

DETROIT

ONE OF FORD'S ENGINES IS HUMMING, ANYWAY

But can its finance division keep up a stellar profit recovery?

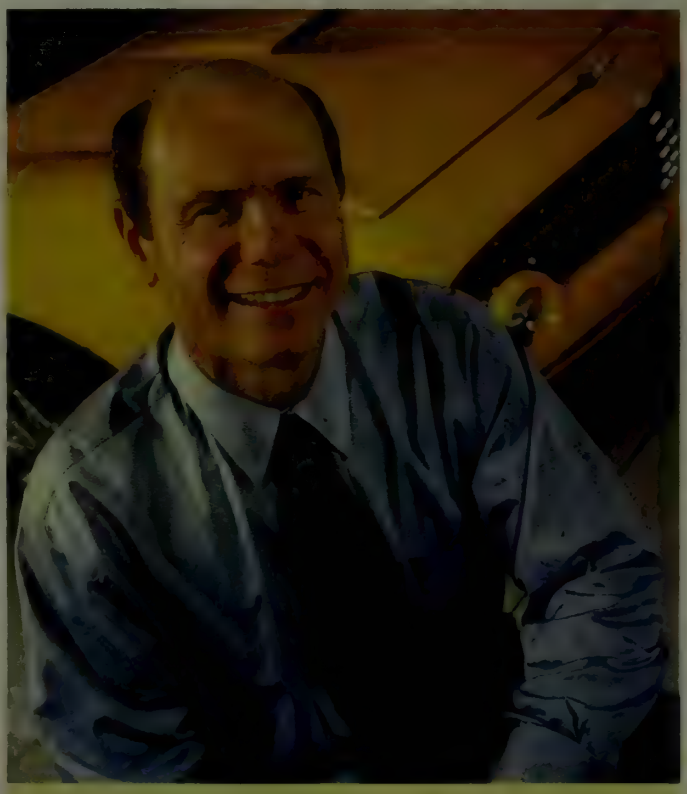
Since late 2001, William C. Ford Jr. has been struggling to overhaul the ailing auto maker his great-grandfather founded 100 years ago just last month. If only it were as easy as the lightning-fast turnaround at Ford Motor Co.'s finance arm.

After all, it was only 18 months ago that Ford Motor Credit Co. was a basket case. Now, under a new leader who took charge in December, 2001, the world's largest auto-finance company is once again Ford's cash cow. Its profit zoomed to $442 million in the first quarter, up 73% from a year earlier, although its results for the rest of the year are expected to be more modest. And after needing a $700 million capital infusion from its parent in January of last year, the finance arm paid Ford Motor a $1 billion dividend in March. Ford Credit, said Goldman, Sachs & Co. analyst Gary Lapidus in a recent report, "is running on nine of eight cylinders."

Credit one of Ford's quintessential company men, Greg C. Smith, for this turnaround. The 51-year-old has been with Ford for 30 years, 21 of them in engineering, planning, and marketing jobs before joining Ford Credit in 1994. Upon taking over, he immediately went to work tightening lending policies and making loan servicing and collections more efficient. Having abandoned a grandiose late-'90s scheme to become a global auto-finance superpower, Ford Credit has exited riskier businesses such as lending to used-car buyers and borrowers with poor credit, and focused instead on loans for buyers of Ford Motor's cars and trucks.

Smith's moves have left Ford Credit better prepared in the event its parent suffers a credit downgrade. Ford Motor's Standard & Poor's rating hovers at BBB, two notches above junk grade. S&P has said it might downgrade the company if it becomes clear that Ford won't break even on its pretax auto sales this year; Ford Credit's rating likely would be lowered as well. Says Ford Credit Chief Financial Officer David Cosper: "Being hitched to a company is going to affect your ra

Nevertheless, a downgrade w spell the disaster for Ford Credit would have in the past. That's b the outfit no longer depends on t ings-sensitive market for uns commercial paper to raise most money it lends. Since 2000, the u reduced its commercial-paper ex from $42 billion to $8 billion, rely stead on much cheaper funding: t of securitized packages of car which are rated AAA. Ford increased securitization from $25 or 13% of its total funding in 2 $55 billio 28%, by ear year.



SMITH: *He has gotten Ford Credit in shape, boosting its parent's bottom line*

Overall, Credit's b sheet is shr as it imple its lowe strategy. Th of loans that it manages pected to drop from $20 lion at the end of 2001 t billion to $185 billion by th of this year. "We have p brakes on the business," Cosper. That smaller po is better managed and s fewer losses, boosting p Credit losses in the first q totaled $493 million, down $912 million in the final ter of 2001.

Certainly, Ford Credit out of the woods yet. U ployment and personal ruptcies continue to rise, ing to more auto-loan de and repossessions. Plu used-car prices—down 10% in the past year— that repossessed cars and returning to the credit a the end of their leases are less. In fact, Ford Credit e tives caution that results fo second quarter (due July 16 subsequent quarters pro won't be as strong as the quarter's. That's partly be the company decided that timing was right in the quarter to do the bulk of year's securitization, in e front-loading a big chunk of profits. Even so, if Ford C continues on its current t it's likely to remain the pac ter in Bill Ford's revival ef

By Kathleen Ke in D

A CREDIT TO THE COMPANY

In 18 months, Ford's finance unit has gone from a liability to an asset for its parent

	BEFORE*	AFTER**
STRATEGY	Expand aggressively via risky loans	Exit subprime, used-car, and non-Ford lending
CREDIT LOSSES	$912 million	$493 million
CASH ON HAND	$3 billion	$12 billion
QUARTERLY RESULTS	$297 million loss	$442 million profit
DIVIDEND TO PARENT	None	$1 billion

*Figures are for Dec. 31, 2001, quarter **Figures are for the Mar. 31, 2003, quarter

Data: Company reports, *BusinessWeek*

THE TROUBLED M-CLASS SUV

COMMENTARY

By Gail Edmondson

MERCEDES' HEAD-ON COLLISION WITH A QUALITY SURVEY

There must be a lot of long faces at the headquarters of the Mercedes Car Group in Stuttgart. On July 8, the world's most esteemed luxury auto maker suffered the humiliation of seeing its ranking in the annual J.D. Power & Associates Inc. survey of car dependability plunge to No. 26 from No. 16 last year, eight slots below the industry average, trailing Chrysler, Ford, and Plymouth. Ouch! In 1990, Mercedes-Benz proudly ranked No. 1. "Once it was the nameplate of envy. It may be losing some of that shine," says Brian Walters, J.D. Power's research director. Problems cited by consumers in the 962-page report included handling, braking, shocks and struts, electronic window controls, and inaccurate fuel gauges.

Sounds more like problems you would expect in a Chrysler, Mercedes' troubled sister brand. But Chrysler and even Dodge outperformed Mercedes in the survey. Quality problems at Daimler raise questions about the impact of the 1998 merger between Mercedes parent Daimler-Benz and Chrysler Corp. on the Mercedes nameplate. Since then, DaimlerChrysler Chief Executive Jürgen E. Schrempp has sent some of the company's best executives to Detroit to fix Chrysler. Is Mercedes paying the price?

Mercedes' famed engineering prowess is hardly *kaput*. The problems cited in the survey affect three specific models from the year 2000. One of them, the midsize E-Class sedan—Mercedes' big money-maker—already has been replaced by a newer version that is winning raves from critics. And the M-Class sport-utility vehicle received an extensive overhaul in September, 2001, including the replacement of 1,100 parts.

Still, consumers' perception of declining quality over time is chiseling away at Mercedes' stellar reputation. Even though Mercedes moved quickly to address the problems, the idea that every vehicle it makes will have superb quality—once the moniker's hallmark—is no longer a given. Another bout of quality problems could raise far more serious doubts among car buyers.

The Germans' weak spot was exposed in the 1990s, after Toyota Motor Corp. and Nissan Motor Co. stormed the U.S. market with lower-cost luxury models. To compete, Mercedes' engineers had to overhaul how they built cars. Instead of letting design determine the cost, engineers had to design cars to meet a target price. "The problem is they weren't good at that," says Philipp Rosengarten, senior analyst at Global Insight in Frankfurt. "The old E-Class was the first Mercedes model designed to cost, and it completely failed." The M-Class targeted in the survey was a victim of cost cuts and accelerated development to meet the challenge of Japanese SUVs. Its interior paint chipped, its wood paneling was defective, and its instrument panel was subpar. "When you come out with an interior that is not a Mercedes, it raises serious questions about what they were willing to do to cut costs," says Paul A. Eisenstein, publisher of TheCarConnection.com. Such quality problems may slam Mercedes resale values, which have long been among the highest in the industry. "Clearly, luxury brands live and die by their [resale] value," says Stephen T. Odell, director and senior managing executive at Mazda Motor Corp.

Mercedes officials insist that the quality problems highlighted in the J.D. Power survey are history, and that cost-cutting does not affect quality at Mercedes. In a similar J.D. Power survey in Europe, for instance, the E-Class maligned by U.S. consumers took No. 1 in the luxury class, in part because Japanese rivals are still scarce, but also because Europeans have different expectations. Of course, customer surveys are subjective and not the final arbiter of quality. But the message is clear: Savvy competition is raising the bar for everyone.

Mercedes' European stronghold won't remain secure forever. Toyota is ratcheting up its marketing efforts for Lexus, and its Yaris subcompact stole a top spot in a recent quality ranking by the German agency that certifies autos as roadworthy. Mercedes, of course, still makes world-class cars. But from here on out, it will be a lot tougher to stay ahead of the pack.

With Chirsitine Tierney in Detroit.

Steep Slide At Mercedes

DEPENDABILITY RANKING

(The methodology of the study, which covers three-year-old vehicles, has changed over the years.)

Data: J.D. Power & Associates

1990	#1
1995	#3
2000	#6
2003	#26

BIG PHARMA

A BARE-KNUCKLE BATTLE OVER CHOLESTEROL DRUGS

If AstraZeneca's Crestor is approved, rivals' stepped-up pitches will focus on safety

For the drug industry, cholesterol-lowering medicines known as statins have become a veritable license to print money. Sold under brand names such as Lipitor and Zocor, they last year accounted for $12.5 billion in sales in the U.S. alone, making them Big Pharma's hottest U.S. sellers. It's no surprise then that drugmakers splashed out $1.4 billion in 2002 to pitch the drugs, according to consulting firm IMS Health Inc., flooding doctors' offices and consumer media with statin promotions.

If doctors and consumers felt a little overwhelmed by last year's marketing blitz, they should brace for a lot more. On July 9, a Food & Drug Administration panel recommended approval of Crestor, a new statin from AstraZeneca PLC. If the FDA goes along with the recommendation, as it usually does, Crestor could be on sale by the end of the summer. That will set off a three-way competition among Pfizer Inc.'s Lipitor and Merck & Co.'s Zocor, which together account for 80% of the statin market, and Crestor. "It will be a bare-knuckle marketing battle," warns Lloyd S. Kurtz, an analyst at investment firm Harris Bretall Sullivan & Smith, which owns stakes in Pfizer and Merck. "There's a lot of money on the table."

AstraZeneca's entry will certainly complicate matters for its rivals. The London-based drugmaker is expected to push the notion that Crestor lowers so-called bad cholesterol more than Lipitor at comparable doses. And analysts expect Crestor to be priced at a discount to both Lipitor—the market leader—and Zocor, the No. 2 statin drug.

But Pfizer and Merck are likely to counter with claims that their pills may be safer. Statins block the production of cholesterol in the liver, triggering the liver to then suck up LDL cholesterol, or bad cholesterol, in the bloodstream. Concerns about health risks from statins grew after the 2001 withdrawal of Baycol, Bayer's cholesterol-cutting drug, due to a potentially deadly muscle-related side effect. While Crestor doesn't appear to pose a similar risk at recommended doses, AstraZeneca's rivals may be able to convince doctors they're better off sticking with statins that have a longer safety record. In addition, the FDA panel recommended monitoring patients on Crestor's highest dose after data showed some test subjects had protein in their urine, a possible indicator of kidney damage. John Pears, AstraZeneca's global me director for Crestor, says the com believes the drug does no such h but analysts expect Pfizer in parti to sow doubts with doctors on point.

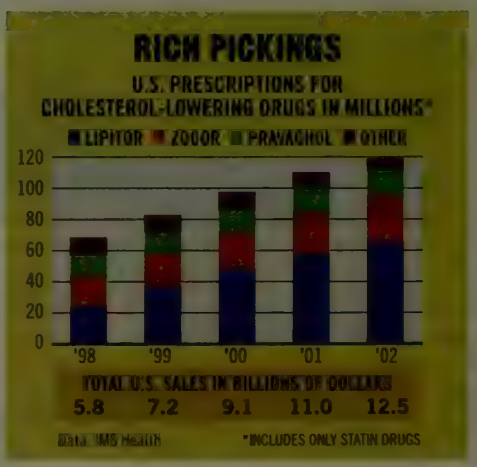
Such question marks could make tors and insurance companies alike tious about Crestor. "I'm going to to know what happens in real-life of this product before I endorse says Robert C. Seidman, chief pha cy officer at WellPoint Health Netw Inc., a major health insurer.

Of course, if Pfizer and Merck ov their challenge, it could backfire. prisingly, sales growth in the statin ket has slowed in recent years. comes despite new data showing benefits of statins on patients with betes and high blood pressure and that it might even help ward off ca and Alzheimer's disease. U.S. pres tions are expected to be up just 8% year, vs. 18% in 2000, says securi firm SG Cowen Securities Corp. Doc and analysts say the publicity rounding the withdrawal of Bay which came after the FDA received ports of 31 deaths in the U.S. linke the drug, have hampered growth the entire class.

Yet no player in this category afford to lose market share. In 2 Merck will lose patent protection on cor, which generated $5.6 billion in s last year. Merck is readying a pill v longer patent protection that combi Zocor with the new cholesterol-lowe agent Zetia from Schering-Plough C Both Merck and Schering, which split profits from the sales of that c bo drug, desperately need the hy pill to be a hit.

At the same time, AstraZeneca fa market erosion of its big-selling st ach drug Prilosec due to generic c petition and needs Crestor to off that decline. Pfizer is relying on Lip to help deliver strong top-l growth that W Street expects. reasons the st battle surely drive up he rates in the exe tive suites of so of the bigg drugmakers years to come.

By Amy Bar in Philadelph with John Carey Bethesda, Md.



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COMMENTARY

By Stanley Holmes

THE REAL NIKE NEWS IS HAPPENING ABROAD

Ever since Nike Inc. missed its fourth-quarter earnings target by a penny at the end of June, its stock has languished. Investors are spooked by two things: a 10% decline in advance orders of Nike merchandise in the U.S. and uncertainty about the company's tense relationship with Foot Locker Inc., its biggest customer. "Like it or not, the Street looks to Nike's U.S. business as a benchmark" for the entire company, says Wells Fargo & Co. analyst John J. Shanley.

NIKETOWN IN BEVERLY HILLS

That's too bad, because Nike is a global concern these days. For the first time, Nike is raking in more revenue overseas than in the U.S.—$5.1 billion to $4.6 billion for the fiscal year ended June 30. That's thanks to rocketing sales of soccer gear, athletic shoes, and apparel in Europe, Asia, and Latin America. As a result, the Beaverton (Ore.)-based sneaker maker has some breathing room to fix its problems at home. On July 9, Nike took a step in that direction when it announced its intention to buy Converse for $305 million—an attempt to get traction in the hot U.S. market for retro footwear.

While Nike wants to shore up the home front, it clearly believes much of its growth will come from overseas. Sure, Nike's foreign operations are less profitable than its U.S. business—18% pretax profit margins vs. 21%. And favorable currency rates have boosted Nike's gains overseas. But even in constant dollars, sales growth in Europe and Asia last fiscal year reached high single- and double-digit growth, respectively. Says Goldman, Sachs & Co. analyst Margaret Mager: "Growth will come from international markets."

Overseas, Nike has duplicated its U.S. marketing strategy: Sign up big-name athletes to sell shoes and apparel. Kids from Rome to Rio de Janeiro take their cues from the likes of Brazilian soccer star Ronaldo. Nike's partnership with Manchester United, the world's most popular soccer team, also seems to be paying off. Last fiscal year, Nike's global soccer business generated $720 million in sales, up from $500 million in fiscal 2002. And Nike's hot-selling high-tech Cool Motion jerseys and fashionable Sphere line helped lift apparel revenues in Europe by 16%, to $1.1 billion, and 24% in Asia, to $500 million.

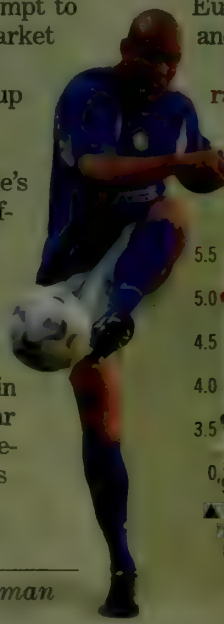
Nike is running a different race in the U.S. The company's key basketball franchise is a mature business. It recently spent $165 million to sign up NBA star Kobe Bryant and up-and-comers LeBron James and Carmelo Anthony to flog its products. But it's hard to grow in a market that has been stagnant for a decade. Making matters worse, Kobe was accused in early July of sexual assault. Kobe denies the allegations, but his troubles could become a big issue for Nike.

The feud with Foot Locker should be easier to solve. A year ago, Foot Locker asked to sell fewer premium Nike shoes and offer steeper discounts. Nike refused but says it is talking through the problem with the retailer, even as it starts moving the pricier shoes to others. Nike needs to sort this out soon. Foot Locker ordered $1.1 billion worth of Nike shoes in fiscal 2001; last year, orders totaled $800 million.

Nike also is out of step with America's tastes. Since the late 1990s, consumers have drifted from athletic sneakers toward retro runners, sandals, and other street wear. That's where the Converse acquisition would come in. The 95-year-old company has benefited from renewed interest in its classic Chuck Taylor All Star basketball shoe and Jack Purcell tennis sneaker. "This is a good move for them," says John Horan, publisher of *Sporting Goods Intelligence*, an industry newsletter. "In the short term, it helps them win back some of the classic shoe market. In the long term, it positions them to grab more share of the U.S. market."

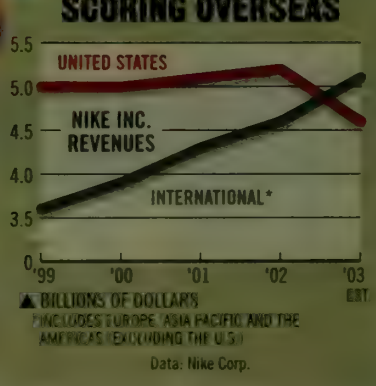
Still, the U.S. footwear business has slowed to a walking pace. Even Nike makes up with Foot Locker and produces more classic shoes, it will never return to high double-digit growth rates. But it no longer has to—so long as it keeps on just doing it overseas.

Holmes covers Nike from Seattle.



RONALDO: *Nike's soccer pitchman*

SCORING OVERSEAS



Data: Nike Corp.

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In Business This Week

EDITED BY MONICA ROMAN

TENET'S CONDITION ONLY GETS WORSE

SEVEN MONTHS AFTER LAUNCHING an informal investigation of embattled hospital chain Tenet Healthcare, the Securities & Exchange Commission has stepped up its probe. On July 9, the Santa Barbara (Calif.) company revealed that the SEC subpoenaed documents concerning Tenet's Medicare billing and other financial practices. The disclosure came two weeks after Tenet warned earnings for the year ending July, 2004, could be 30% lower than expected. Tenet is facing a number of industry pressures, including insurers that are no longer willing to pay high prices for hospital services.

GLOBAL CROSSING'S STAR-CROSSED DEAL

THE DEFENSE AND HOMELAND Security Depts. may oppose Singapore Technologies Telemedia's bid to acquire control of bankrupt telecom provider Global Crossing on national security grounds. Similar concerns prompted Hong Kong's Hutchison Whampoa to pull out of a joint bid earlier this year. A bankruptcy court judge approved the proposed acquisition on July 1, but the deal must still pass muster with the Committee on Foreign Investment in the U.S., a consortium of federal agencies. If Washington nixes the deal, it would open the door to rival bidders, including IDT, which has expressed interest, and financier Carl Icahn's XO Communications, which already controls more than one-third of Global Crossing's bank debt.

CLOSING BELL

EXTRA CASH

NCR investors cheered on July 9 when the maker of ATMs said second-quarter profits would top forecasts. Although Dayton (Ohio)-based NCR's business hasn't rebounded, it said cost-cutting would push profits to $6 million or more, vs. the $4 million loss analysts expected. Shares rose 13.5%, to $32.25.

MCI: FIRST, THE GOOD NEWS . . .

FOR MCI INVESTORS, IT WAS the best of weeks and the worst of weeks. They'll receive $750 million in cash and stock as part of a settlement of civil fraud charges with the SEC, which was approved on July 7 by the company's bankruptcy court judge. On the same day, however, MCI reduced its 2005 revenue projections by $3 billion. It cited steep price declines in services ranging from consumer long distance to high-speed Internet access. Winning court approval of the SEC settlement removed a major obstacle for MCI. But a greater hurdle still remains: rebuilding a financial base on which to resurrect the second-largest telecom company when it emerges from bankruptcy, expected some time this fall.

THROWING A LIFELINE TO NAUTICA

WRANGLER JEANS MAKER VF has decided to rescue floundering Nautica, known for its maritime motif clothing. VF agreed to pay $585.6 million for Nautica, whose men's sportswear unit has struggled in recent years after straying from its original casual look to more contemporary designs. Nautica is fetching a good price—$17 a share in cash, or a 28% premium over the price of its stock when the deal was announced. Greensboro (N.C.)-based VF hopes to use Nautica as a springboard to reach beyond mass marketers such as Sears Roebuck and to enter upscale department stores.

A '90s LEGACY: HYPERTENSION

MORE BAD NEWS ABOUT THE nation's health. Hypertension, the leading cause of stroke and heart failure, rose in the 1990s after three decades of decline. A study published on July 9 in the *Journal of the American Medical Association* found that one in three U.S. adults—58.4 million people—had high blood pressure in 1999-2000. That's almost 4% more than the last national survey conducted between 1988 and 1991. The new study, conducted by doctors from the University of South Carolina and the Medical College of Wisconsin, also found that nearly one-third of adults with high blood pressure are unaware of their condition, and that only 34% had their condition properly under control. The authors put much of the blame on the rising obesity rate.

HEADLINER: JOE TUCCI

SOFTWARE SAFARI

Ever since Joseph Tucci became CEO of data-storage powerhouse EMC in early 2001, he has promised to make high-margin software a larger part of the hardware company's revenue mix. He had little choice: Hardware prices have been falling by at least 40% a year, destroying the once high-flying profit margins at Hopkinton (Mass.)-based EMC.

Now, Tucci is finally delivering. On July 8, EMC announced it would buy Legato Systems of Mountain View, Calif. After the deal closes in December, Legato could nearly double EMC's software sales and increase software's share of total revenue, from the current 22% to 24%. E shares fell 4.3%, to $11.24, on the news, while Le to's shares climbed 8.9%, $9.91.

Big deal? W Tucci isn't ished. He wa software to m up 30% of EM sales by the end 2004. To get there, Tu says he'll continue shoppi He vows to pick up m software companies "of so size" over the next months to reach his goa and keep the battered E in the black.

Faith Ar

ET CETERA . . .

- Yahoo! reported a sec quarter profit of $51 mi and raised its annual fore
- Irene Rosenfeld resig as president for North Am ica of Kraft Foods.
- New rules require pa aged foods to carry labels closing the level of trans-

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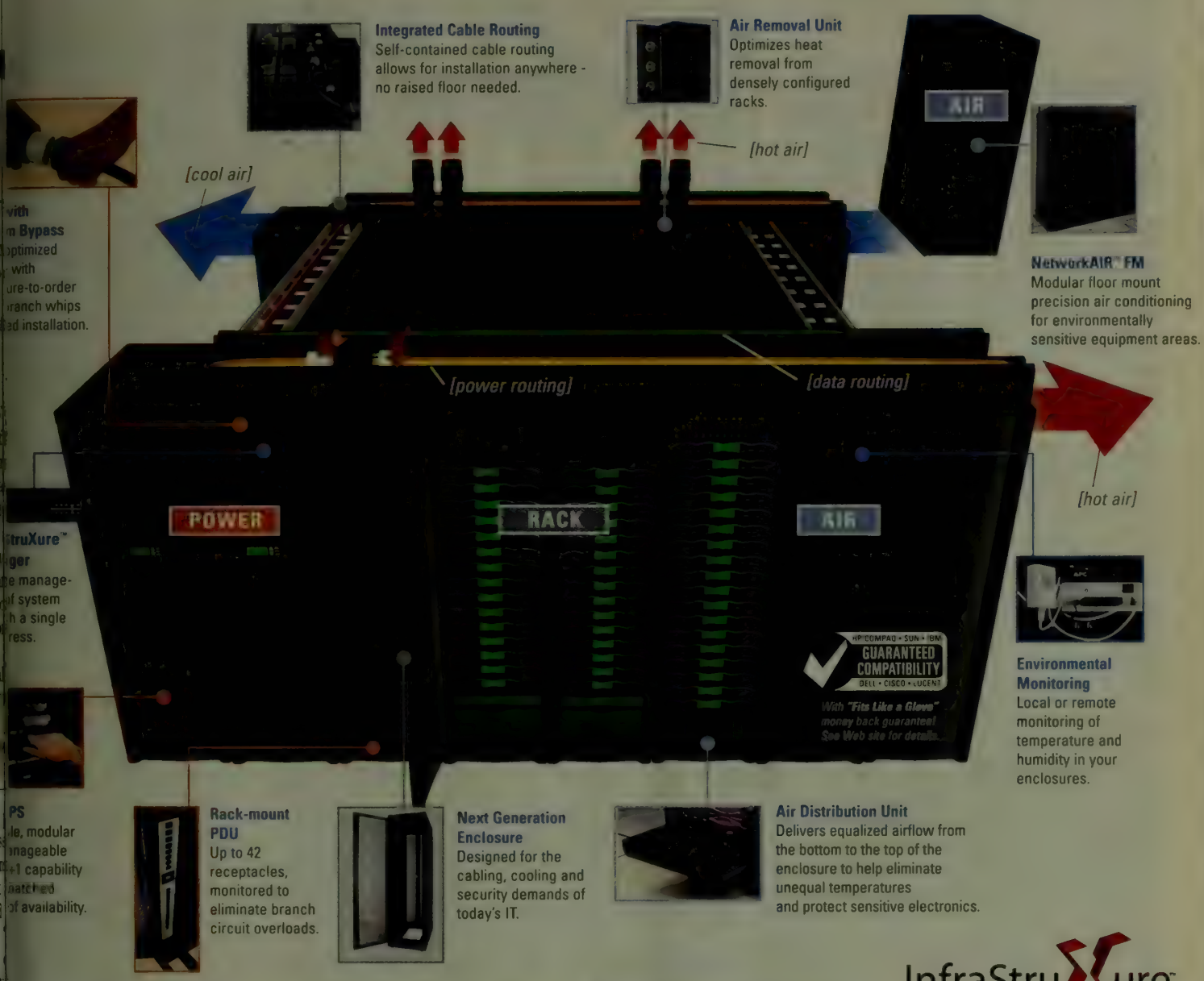

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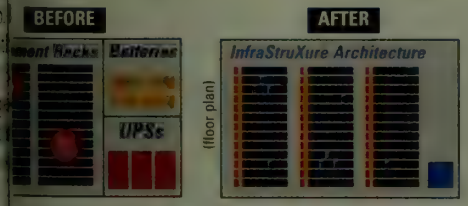

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EDITED BY RICHARD S. DUNHAM

HANDICAPPING THE NEW TEAM AT TREASURY

Seven months after he was named Treasury Secretary, John W. Snow is finally putting his team in place. On July 9, he moved to fill two key vacancies. Snow tapped Susan C. Schwab of the University of Maryland to be his deputy and Goldman Sachs & Co. investment banker Kenneth H.M. Leet to be Under Secretary for Domestic Finance, Treasury's key liaison to the financial markets. Both officials, who must still be confirmed, get strong early reviews. But it's not clear whether Treasury's new team will have the financial-crisis skills of departing policymaker Peter R. Fisher.

Fisher, who says he's leaving the Treasury Under Secretary job in October for family reasons, helped reopen the markets after September 11 and pushed through the controversial decision to stop issuing 30-year Treasury bonds. He was considered a top candidate to take over the New York Fed but withdrew amid talk he would not get the job.

The new team mixes political acumen and business knowhow. Schwab, a Capitol Hill veteran, also brings international and managerial experience to Treasury. Leet's strength is his Wall Street background and close ties to Snow. "We approached this as a big puzzle and tried to make the pieces fit together," a Treasury official says. Both are team players—a requirement in Bushland.

Schwab, 48, dean of Maryland School of Public Affairs, is filling a post that has been vacant since Kenneth W. Dam resigned on Feb. 4. Incoming Budget Director Josh Bolten had pushed one of his confidants for the job, but Treasury resisted. Snow, who had hoped to find a woman with a financial background to take the No. 2 spot, couldn't come up with anyone. Schwab came to the attention of Treasury aides after Bush floated her name for a job at the U.S. Export-Import Bank. A Commerce Dept. official in George H.W. Bush's Administration, Schwab is a protégé of former Senator John C. Danforth (R-Mo.), whom she worked with for eight years in a variet capacities. "She has a lot of the characteristics of Danfo says well-connected GOP lobbyist Wayne L. Berman, worked with Schwab at Commerce. "She's smart, delibera and deeply informed on a wide range of subjects."

Given her Washington background, Schwab, who worked at one point for Motorola, is expected to hit ground running. Her Hill ties should serve Snow well w he tries to sell the next installment of Bush's tax-cut agenda to increasingly skeptical lawmakers. Her interna al background—including a 1980-81 stint at the U.S. Emb in Tokyo—shores up a weak at Treasury.

FISHER: *Out*

LEET: *In*

SCHWAB: *In*

To make up for Schwab's of financial experience, Snow counting on Leet. He joins G man alums Bolten and Step Friedman, head of the Nati Economic Council, in the Adm tration. But it was Snow's deci to bring him on board. The for CSX Corp. CEO got to know when they worked together CSX's sale of its Sea-Land uni 1999. Snow told aides he wa Leet when Fisher first talked of leaving months ago.

Goldman colleagues describe Leet, 45, as a creative ba with broad expertise in both smokestack industries an nance, a definite plus as he helps shape economic policy. he lacks Fisher's nitty-gritty knowledge of the bond currency markets. Given that, Leet is unlikely to reverse predecessor's decision to kill off the 30-year bond. "H have good understandings of markets," says Senator Jo Corzine (D-N.J.), a former Goldman exec, "not as much as ter Fisher but more than adequate with his horsepo work ethic, and experience." Still, the true test will come financial crisis hits.

By Rich Miller, with Emily Thornton in New Y

CAPITAL WRAPUP

THE HEAT IS (STILL) ON

► Senate Banking Committee Chairman Richard C. Shelby (R-Ala.) will put the financial-services biz under a microscope in hearings starting in September. On the conservative populist's agenda: the "global settlement" between Wall Street and regulators over analysts' conflicts of interest; the 2002 Sarbanes-Oxley corporate reform law; and 1999 legislation that removed legal barriers to mergers among banks, insurers, and securities firms.

CORPORATE BOARD REFORM

► The SEC is trying to mollify Corporate America while it gives shareholder activists more clout. A report due on July 15 will recommend that investors with a critical mass of shares be allowed to put director nominees on the proxy ballot at companies where a majority of shareholders voted to open up the proxy. Activists say it's a good start. Still, business is likely to oppose the move, which would curb CEOs' power to handpick directors.

NOT THE YEAR OF THE WOMAN

► Don't expect 2004 to be a banner year for female candidates. Democra pollster Celinda Lake, an expert on political trends involving women, say male office-seekers may have an edg "Times of war, recession, and nationa security [concerns] are tough times f women's leadership," she says. Why? Many voters cling to sexual stereotypes. "We have women as tough as the men," Lake says, "[but] public pe ception is a little different."

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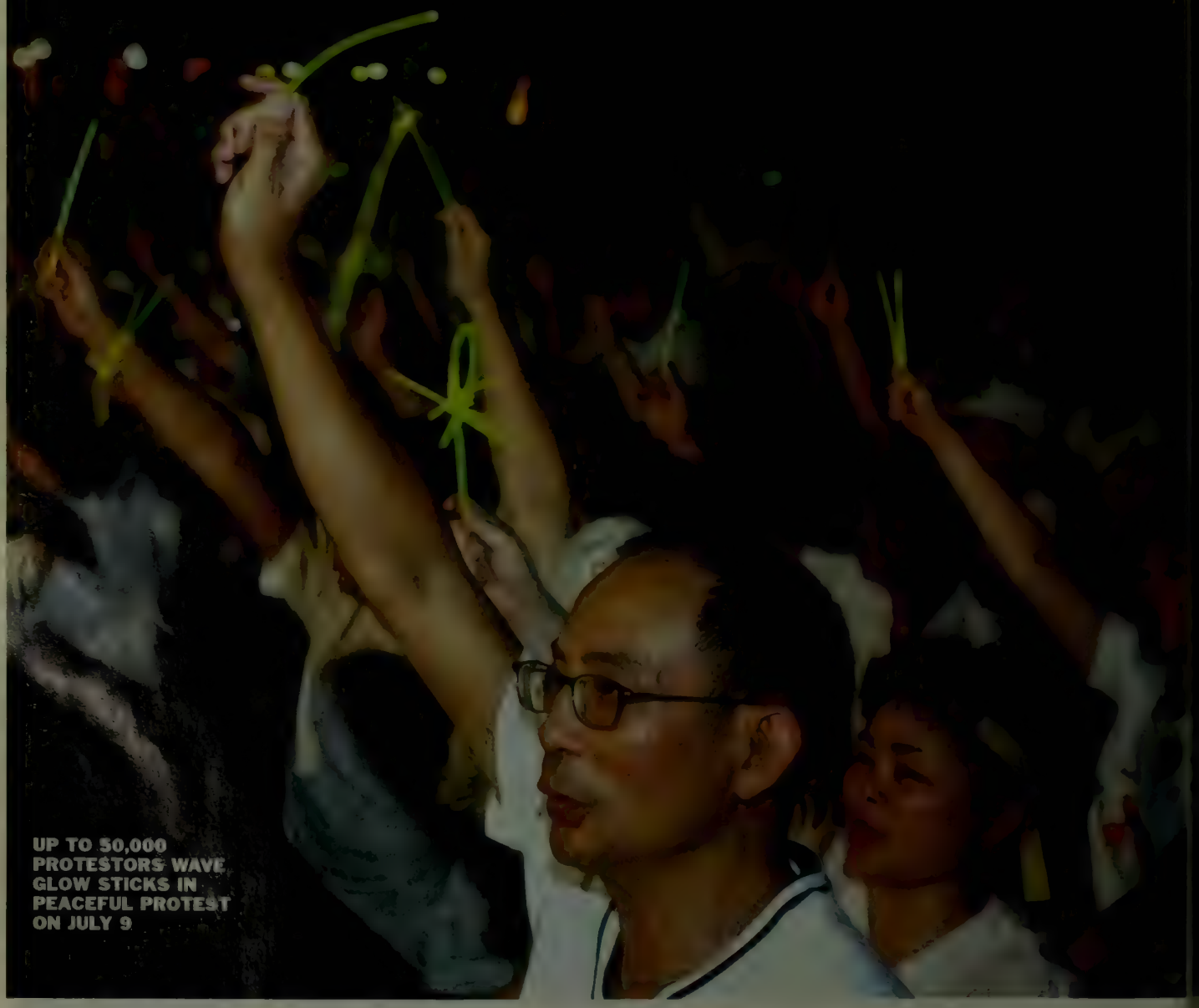
HONG KONG REVOLT

WHAT IT MEANS FOR CHINA



UP TO 50,000 PROTESTORS WAVE GLOW STICKS IN PEACEFUL PROTEST ON JULY 9

If Beijing were to mishandle this outbreak of people power, the damage to its global standing would be huge

t has been a kid-glove uprising. On July 1, a half-million Hong Kongers took to the streets, but they marched peacefully, even respectfully. Parents brought children. Kids walked hand-in-hand with grandnts. Then, on July 9, as many as 00 more came out for a vigil in the . Instead of candles, they used glow ks—the better to avoid sullying ntown streets with wax drippings. y wore color-coded ribbons: Red to est bad government, yellow to show osition to a new national security blue to demand the resignation of g Kong Chief Executive Tung Chee. Even T-shirts calling for Tung to down said: "Please."

eaceful, yes. But for Communist y leaders in Beijing, Hong Kong's mer of discontent could still be a tmare. The demonstrators repre- one of the biggest challenges to Chinese leadership since the proocracy movement in 1989 that endwith the Tiananmen Square mas-e. Beijing has always worried that ocracy would spin out of control in g Kong—precisely the kind of thing new national security law was deed to prevent. Instead, attempts to the law through Hong Kong's usutoothless legislature have acceler- the city's democratization. "People willing to stand up and be counted," Ronnie Tong, former chairman of Hong Kong Bar Assn.

he unprecedented protests kicked a political crisis that shows no sign of ing. Imminent pas- of enabling legisn for Article 23, national security ion of Hong Kong's ic Law—the ministitution that gov- Hong Kong—is t brought the onstrators togeth- They feared the ute would give offis sweeping powers rack down on dis-, the press, and orized religion. It's a ply held fear rooted he fact that many Hong Kong's 6.8 mil- residents had fled oppression of the nland.

Although Tung wa- d down some provisions, he otherwise refused to back off, saying he was just fulfilling his constitutional duty. But on July 6, James Tien, a key Cabinet member, resigned when Tung refused to delay a vote on the law. After a hurried, late-night Cabinet meeting, a shaken Tung emerged at 2:00 a.m. on July 7 to announce that he would indeed postpone the vote. Now, the swelling ranks of Tung's enemies want the chief executive out as well.

The protests crystallized a host of grievances against Tung's administration. Demonstrators blame him for mismanaging the economy, bungling the fight against SARS, and listening too carefully to Beijing and not enough to local opinion. The anger also reflects a deep fear that under the 66-year-old Tung, Hong Kong is losing its uniqueness despite Beijing's pledge to create and maintain "one country, two systems." Hong Kong, they worry, is turning into just another troubled megalopolis. "Tung is pulling Hong Kong down and narrowing the gap between us and China," says camera-shop owner K. K. Poon. Many Hong Kongers want to stop that degradation. Tung "has converted an apathetic and apolitical mass into an angry populace," says Gordon Chang, an author and frequent critic of Beijing.

TUNG: *Beijing has little loyalty to him but doesn't want to be seen as bowing to protestors*

The question is, how will Hong Kong's newfound defiance affect the vast and roiled political landscape of mainland China? There's no concern that Beijing will send its army troops stationed in Hong Kong into the streets. That itself is remarkable, given the fears that surrounded the 1997 handover to China. But if Beijing were to mishandle this crisis, the damage to China's international standing would be huge. For untested President Hu Jintao and Premier Wen Jiabao, the alternative—sacking Tung—is every bit as risky. It could put them at odds with the old guard in the central government and show that taking to the streets gets results. That's a message the leadership doesn't want to send either to the mainland or Hong Kong. "Once people have participated in one demonstration, it's much easier to get them to a second and a third," says Martin Lee, former head of the opposition Democratic Party and a leader of the drive against Article 23.

This demonstration of people power comes at an especially uncomfortable time for Beijing. The country is still recovering from its encounter with SARS, which shook popular faith in the central government until Hu acknowledged the severity of the crisis. And further meddling in Hong Kong would send the wrong signal to already-skittish Taiwan, which Beijing hopes to entice into a relationship like the one it has with Hong Kong.

Officially, Beijing is at ease with the events in Hong Kong. "We believe Hong Kong citizens, under the leadership of Tung Chee-hwa's administration, will sail through the current difficulties," a foreign ministry spokesman said on July 8. But it is no secret that Hu has little allegiance to Tung, who was handpicked by former

WHAT THE FUSS IS ALL ABOUT

Article 23 is a part of Hong Kong's Basic Law, a mini-constitution written to govern the territory for 50 years after its return to Chinese rule in 1997. It calls for Hong Kong to enact laws prohibiting "treason, secession, sedition, subversion...[and] theft of state secrets." Last September, the Hong Kong government created a draft national security measure, which it planned to give final approval on July 9. Opponents criticized the bill for allowing arbitrary police raids and shutting down groups linked to political and religious groups banned on the mainland. Just as bad, they said, it included language on official secrets that could be used against journalists and whistle-blowers. While the government trimmed some of the more objectionable provisions, critics say the measure remains too harsh and shouldn't be rushed into law.

SECURITY SECRETARY REGINA IP

President Jiang Zemin. By dumping Tung, Hu and his allies could gain an edge in their power struggle against Jiang, who still wields enormous clout as head of China's military. "The government is not bound and chained to Tung," says a Western diplomat in Beijing. "He's not Hu's man, and he is not widely liked in Beijing." Technically, Beijing has no power to force Tung out, and Hong Kong law doesn't provide for the recall of the chief executive. But Hu could surely get Tung's resignation if he applied enough pressure.

Hu's biggest fear is that by bowing to the demonstrators in Hong Kong, he will encourage domestic dissent. In a sign of just how nervous the protests made China's leaders, mainland newspapers completely ignored the July 1 march. Yet millions of residents of neighboring Guangdong province watch Hong Kong TV and saw blanket coverage of the masses of demonstrators filling Victoria Park. "There have been all kinds of reports on the protests we can see on Hong Kong television," says a Guangzhou businessman. Enterprising Internet surfers were also able to catch wind of the protests. If mainlanders "see Hong Kong people peacefully go out on the street and get what they want, that will be a threat to the rule of the Communist Party," says Albert Cheng, a popular radio talk-show host and longtime critic of Tung. Already, China faces protests across the mainland practically every day by laid-off workers, overtaxed farmers, and city-dwellers booted from their homes. "The central government sees this quite clearly now as its own crisis," says Shi Yinhong, a professor at People's University.

The irony is that Hong Kongers' wrath focuses on Tung, not Beijing. "No one wants to overturn the Chinese government," says Stephanie Choi, a 65-year-old shopkeeper who marched in both demonstrations. "Most of us like the new Mr. Hu." In the crisis over SARS, Hu won popular support by admitting the government's failings. Greater openness was furthered by the revelation of a submarine disaster in China's northeast in May and the punishment of top naval brass. When China's media reported that a graphic designer in Guangdong died in police custody, Beijing changed laws that had allowed the detention of workers without local residency permits.

Meanwhile, Tung's popularity keeps sinking. He's losing the support of the all-important business community—which until now had generally backed him. Some think he bows too much to Beijing. Others grumble that he's too soft on the opposition. "The government has no credibility anymore," says a pro-Beijing industrialist. "Something has to change." At a minimum, several Cabinet members could be sacked. Prime candidates are Finance Secretary Antony Leung and Secretary for Security Regina Ip, who oversaw the push to ram Article 23 through the legislature.

In the middle is Tung, an avuncular ex-shipping tycoon with a fondness for reading Chinese history and doting on his grandchildren. When he was ta to run Hong Kong after Britain's parture, Tung appeared to be a ge oligarch, an insider with enough pu the mainland to manage the hand and still preserve what was un about Hong Kong. But from the s Tung committed a series of gaffes presided over a number of economi versals, some not of his own ma To name just a few:

- Unemployment has climbed stea reaching a record 8.3% in May.
- Land magnates were angered w he awarded a choice piece of waterf to tycoon Li Ka-shing's son Ric without putting the property up for
- A 65% drop in land values sav the fortunes of ordinary Hong Kon and created the most ruinous defl in Asia outside of Japan. Tung al released more government land on market, a move that would have property prices even more. Pop protest stopped him.
- The budget, once the most tig run in Asia, swung into deficit—the will probably reach 7% of gross do tic product by yearend. And he ang Hong Kongers by raising taxes.

Throughout, Tung's political s were clearly lacking. There was w spread anger at his refusal to sack nance Secretary Leung when he se ly bought a Lexus sedan just w before announcing a tax hike on cars in February. Then, as the th of SARS was receding, Tung put Health Sec-

NINE MONTHS OF ANGER

A proposed national security measure called Article 23 has Hong Kongers seething

SEPT. 23, 2002

Proposal for Article 23 law introduced.

OCT. 23

Civil rights leader Martin Lee meets with U.S. National Security Adviser Condoleezza Rice, who says: "We share your concerns" about Article 23.

OCT. 25

George Bush tells

IN 2002, THEN-PRESIDENT JIANG MET WITH BUSH

Chinese leader Ji Zemin during a v Crawford, Tex., t U.S. is concerne Article 23 laws.

OCT. 28

Article 23 pointw Regina Ip provok opponents by off Hitler's rise to p Weimar Germany

eijing media ignored the protests, but mainlanders who get Hong Kong TV or have Web access saw everything

ry E.K. Yeoh—the target of h criticism for his handling of outbreak—in charge of a e into the causes of the cri- provoking more outrage. And ne debate on Article 23 heat- p, Tung and his advisers dis- ed initial opposition as the k of an anti-Beijing fringe. incredible how they under- mated the sentiment," says chief of a large Hong Kong ing company.

ung has said little since the s started. On July 7, look- exhausted, he read a brief ement to the press. "What ost important is to get our omy going again," he said. n, a few hours before the July 9 l, he told government radio: "We be listening to their concerns." So investors aren't panicking: The chmark Hang Seng index has risen rly 5% since July 1.

ong-term, there could be a toll on economy. The territory has promised liminate its budget gap by 2007. To hat, the Legislative Council will l to approve new spending cuts. But he government's legitimacy suffers use of the demonstrations, Hong gers will have little stomach for any erity—and they'll be more likely to take to the streets. "The outcome would be pressure for easier fiscal policy and more spending on social services—which isn't compatible with bringing the deficit down," says Michael Spencer, chief economist for Asia at Deutsche Bank in Hong Kong.

WEN AND HU: *Their openness has been warmly received*

The crisis also threatens to pull Beijing into Hong Kong's affairs more than anyone in the territory wants. Under the Basic Law, Hong Kong was given the right to run its internal business for 50 years after the 1997 handover. But since the crisis erupted, high-profile advisers from Hong Kong have jetted to Beijing, and the central government has sent fact-finding teams to assess the mood. "The last thing we want to do is ask the central government to intervene," worries a former senior official. "It really is a very delicate situation."

While it's too early to say where the political crisis will end, nearly everyone agrees that when the legislature again considers the national security bill this autumn, it will be a far milder version than the original. "Article 23 is over—it has been defanged," says Mark Simon, deputy general manager at *Apple Daily*, a newspaper that has led opposition to the law. "The next thing is Tung." Whether or not Tung is, in fact, the next thing, the opposition vows to press on. Hong Kong's Basic Law allows for direct elections of all legislators and even the chief exec after 2007—something Tung has refused to discuss. "The bigger picture must be the demand for political reform," says opposition Legislative Council member Emily Lau. "This is a watershed." That's certainly true for Hong Kong—and for China, too.

By Mark L. Clifford, Bruce Einhorn, and Frederik Balfour in Hong Kong and Dexter Roberts in Beijing, with Miguella Lam in Hong Kong

BusinessWeek online

For more on the turmoil in Hong Kong, please visit www.businessweek.com/magazine/extra.htm.

OPPOSITION LEGISLATOR LAU

at democracy is no e of freedom.

DEC. 24

omment period on 23 ends. Govern- later criticized for g submissions uring consultations.

AR. 15, 2003

uses to sack Finance Secretary Antony Leung, who had secretly bought a new Lexus sedan just days before enacting higher taxes on new cars.

APR. 2

WHO advises against travel to Hong Kong because of SARS. Tung comes under fire for the government's slow response to the disease.

JUNE 14

Popular talk show host Albert Cheng is warned to tone down his rhetoric after he compares an official to a dog, sparking fears of curbs on free speech.

JUNE 17

Government announces that unemployment rose to a record high of 8.3%.

JULY 1

A half-million Hong Kongers take to streets to protest Article 23.

JULY 5

Tung agrees to water down the legislation by rewriting key clauses.

TIEN RESIGNED IN PROTEST OF ARTICLE 23

JULY 6

Cabinet member James Tien resigns, throwing the government into chaos and making passage of the measure virtually impossible.

JULY 7

After a late-night Cabinet meeting, Tung postpones a vote on Article 23.

JULY 9

Some 50,000 demonstrators hold an evening vigil.

DAKAR FISH MARKET: TINY LO
LET THE POOR START BUSINES

COMMENTARY

By Pete Engardio

A WAY TO HELP AFRICA HELP ITSELF

As President George W. Bush completes his July 7-12 swing through impoverished African nations, he is encountering a continent whose economic and social problems are so immense it's hard to tell where to begin. Even in the two areas where the Bush Administration is putting its emphasis—fighting the HIV/AIDS epidemic and quelling civil war in Liberia—critics complain the U.S. is doing far too little to make a real difference.

But another Bush action that has received little fanfare holds great promise for making a dent in African poverty. On June 19, Bush signed a law authorizing $375 million in fiscal 2003 and 2004 for institutions that dispense tiny loans of $50 and up to poor people who want to start businesses. Many of these "microloans" are targeted for Africa. The sum is a $65 million increase over existing levels for those two years, and the bill directs the U.S. Agency for International Development (USAID) to ensure that most of the money reaches the world's poorest.

That may sound like chump change, considering that 166 million people in Africa are desperately poor. But from Bolivia to Indonesia to Uganda, microlending programs are proving that small sums can dramatically lift living standards. In the past five years, the number of such banks has tripled to 2,200 and now reach 52 million people around the world, by one estimate. Says Katherine McKee, director of micro-enterprise development at USAID: "In every part of the world, in widely varying circumstances, people have found ways to make microcredit work." If the added U.S. funds are spent wisely and are used to get other nations to cough up, that impact could eventually be enormous.

The aim of microcredit is to foster sustainable economic activity at the grassroots. Typically, a microcredit bank lends about $100 for four months. To help ensure that the interest-bearing loans are repaid, the microcredits provide business and bookkeeping expertise. Upon repayment, the fledgling entrepreneurs get fresh loans. In Bangladesh, where microcredit was pioneered in the 1970s, hundreds of thousands of enterprises started with microloans have helped generate 5%-a-year economic growth for the past decade.

Such successes have prompted similar programs in Africa. In Uganda, a country Bush visited, 245,000 families have borrowed from village banks run by international and local agencies. The money has been used to start everything from rabbit farms to grocery stores. Microlenders "are reaching more people than Uganda's entire commercial banking sector," says Lawrence Yanovitch, policy director for the Foundation for International Community Assistance (FINCA), which runs a global network of microcredi banks, including one in Uganda.

This isn't to say that all money thrown at microcredit pays off. In fact, only a handful of the thousanc of startups are big enough and suf ciently well-managed to stand on their own—without constant infusions of charity. Dispensing and tracking tiny loans consumes lots o time and labor. As a result, despite high rates of repayment, few micr credit banks make money.

The ultimate goal is to make thes banks financially sustainable so they can reach many more people. Alrea some microcredits have become suff ciently experienced and efficient to make a profit while still catering to the poor. Some are even raising cap tal on the open market. A bank sta ed by FINCA in Uganda has 36,000 clients borrowing an average of $137—and boasts an 11% return on equity. It now is seeking a commerc banking license and aims to sell equ ty to private banks.

So far, the Bush Administration hasn't spelled out its strategy for im plementing its microcredit programs much less where it will spend the money. But with many successful models across the developing world, the U.S. has an almost surefire way to make a real difference.

Engardio writes about global economic issues.

ITED BY ROSE BRADY

HECHNYA: PUTIN'S PEACE PLAN EEMS DOOMED TO BACKFIRE

ussian President Vladimir V. Putin reacted fiercely to Moscow's first-ever suicide bombing on July 5. "There is no point in trying to cure these people. They need to be out of the cellars and caves in which they hide and be ed out," he declared at a government meeting two days r two women blew themselves up outside a Moscow rock ival, killing at least 14. One of the bombers was con- ed as a resident of the breakaway republic of Chechnya. he timing of the suicide attack may have been coinciden- But it came just a day after Putin an- nced his plan to hold a presidential elec- in Chechnya on Oct. 5. The controversial eme is the latest step in his four-year rt to settle Russia's 11-year conflict with chen separatists, which has killed more n 14,500 Russian soldiers and tens of usands of Chechen civilians. Putin wants install what he calls a "legitimate gov- ment" in Chechnya—an elected one that ld replace the current Moscow-appointed inistration but still swear allegiance to Russian Federation.

chieving that goal is important to Putin ause he plans to run for reelection next ng, and his supporters in Parliament face tions this December. Putin built his po- al reputation pledging to take a tough line to end the chen conflict, and voters are still waiting for results. stern leaders, including George W. Bush, are also con- ed about the outcome: Islamic militants the world over in- asingly identify the Chechen struggle as part of their ade against "infidel" civilizations. "I don't think anyone rel- s the prospect of an independent Chechen state," says S. Ambassador to Russia Alexander Vershbow.

ut Putin's peace plan, as it now stands, seems doomed to kfire, and could even lead to more violence. The reason is t the plan seems crafted to stage the triumph of the sole Chechen leader whose authority the Kremlin recognizes: Akhmad Kadyrov, whom Putin appointed three years ago to head the regional administration. Putin appears determined to freeze out of the process anti-Kadyrov leaders such as the prominent separatist Aslan Maskhadov. Even though Maskhadov condemns suicide bombings, Putin views him as a terrorist and has spurned his offer for talks to end the war.

Critics say that's a mistake. Russian parliamentarian Sergei Kovalyov, a longtime Chechnya watcher, believes no settlement is possible without participation from top rebel leaders. The first step, he advises, should be talks to achieve a cease-fire, if necessary mediated by international groups. An election viewed by anti-Kadyrov forces as a scam could well stiffen rebel opposition. Another problem with the Kremlin's apparent favoritism of Kadyrov is that he is distrusted by ordinary Chechens. As the mufti or religious leader of Chechnya in the mid-1990s, he called for an Islamic *jihad* against Russia. Now he's preaching against separatism while building a power base with the Kremlin's help. "Chechens realize that such a person could betray them again," says Sergei Khaikin, an independent Moscow pollster who visits Chechnya frequently.

KADYROV: *Backed by Putin*

Strangely enough, if Putin were to allow genuinely open elections, they might expose the separatist cause as bereft of public backing. Khaikin says a silent majority of war-exhausted Chechens, perhaps 70%, favors a long-term solution in which Chechnya remains part of Russia. Many believe Chechnya is too weak to survive independently. Others say the cause of armed insurrection is futile.

Putin's hope is that the next few months will mark a turning point in the Chechen conflict. But few Russians, Chechens, or Westerners should count on that outcome yet.

By Paul Starobin in Moscow

GLOBAL WRAPUP

REAKTHROUGH IN KUWAIT?

Although Islamists won about one- ird of the seats in Kuwait's July 6 rliamentary elections, the ruling Al- bah family may not be unhappy ith the outcome. Some pesky critics the family lost. Nearly half of the coming MPs are new, making them sier to handle. "The results give the vernment the opportunity to pass e laws it needs," says Kamel A. Al- arami, a Kuwaiti oil analyst.

But the big question is whether or t the Al-Sabah family will seize the chance to give more power to women and push through privatization and other badly needed economic measures. Much depends on whom the family chooses for the new Cabinet. The family is trying to decide whether to ask the ailing Crown Prince Saad Abdullah al-Sabah to give up his role as Prime Minister. The most likely successor would be his deputy, Sabah al-Ahmad al-Sabah, who has been the day-to-day ruler in recent years. Giving Sheikh Sabah a freer hand might help end the political paralysis that has plagued Kuwait since it was liberated from Iraqi occupation back in 1991.

A test case will be progress on Project Kuwait, a long contemplated effort to bring in international oil companies to boost Kuwait's flagging production. Opposition from Parliament and from business interests has hampered the project, but now the oil authorities are pushing ahead. Kuwaiti officials will meet with representatives of oil giants in London in mid-July. A breakthrough on Project Kuwait could help alter the emirate's image as an overprotected relic of state capitalism.

By Stanley Reed in London

COMEBACKS

UP FROM THE SCRAP HEAP

Consolidation has given U.S. steelmakers the heft to compete globally

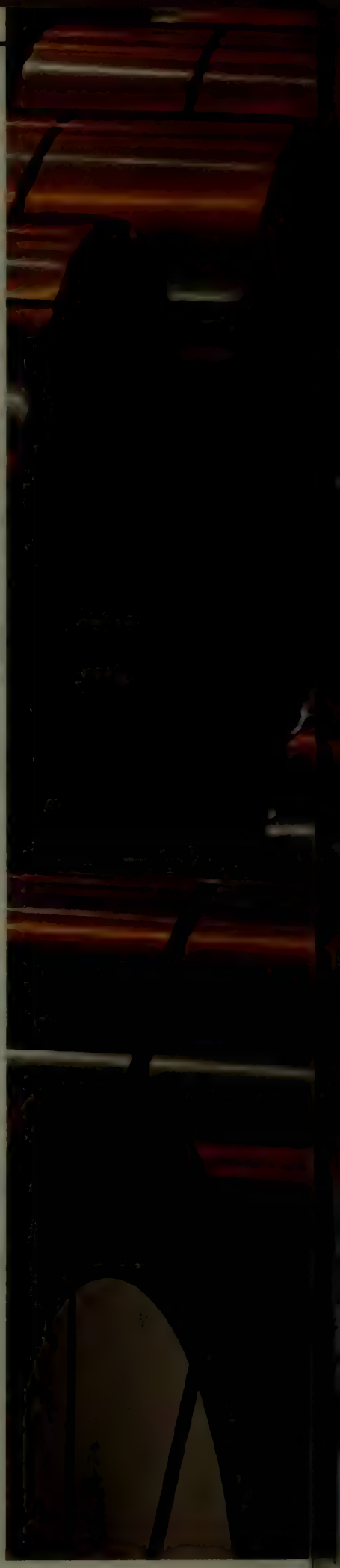
Few companies ever had such a glorious reign as United States Steel Corp. Created in 1901, it debuted as the world's biggest steelmaker and the first American company to top $1 billion in market capitalization. Over the next 100 years, it produced the steel for the Panama Canal, the Empire State Building, the San Francisco-Oakland Bay Bridge, 911 ships during World War II, the Superdome in New Orleans, railroads, oil pipelines, tin cans, and upwards of 150 million automobiles. The company built cities, altered the national economy, and lifted generations into the middle class.

But as U.S. Steel entered its second century, it was struggling just to make it through another year. Cheap imports and domestic minimills, with their nonunion payrolls and ultra-efficient shops, were grabbing sales. Customers were disappearing as they transferred work to lower-wage sites outside the U.S. or simply shut down. Pension obligations were ballooning, while management clung to a top-heavy bureaucracy and its sprawling mills gobbled up cash for repairs. Import duties helped, but Pittsburgh-based U.S. Steel still lost $218 million in its centennial year, its fourth annual loss in a decade. Its global rank: a humbling 10th place.

U.S. Steel's comedown is by no means exceptional. With the world awash in steel, three dozen steel companies have plunged into bankruptcy in the U.S. since 1998, including three of the nation's top five producers and two brand new minimills. The most recent victim: Weirton Steel Corp., which declared Chapter 11 in May. Over the same span, more than 35,000 steelworkers—one in every three, by the industry's count—have lost their jobs, while the government has been forced to pick up the pensions of some 230,000 retirees and dependents. And even though U.S. steel capacity has shrunk to pre-1993 levels, worldwide capacity now tops 1 billion tons a year, exceeding global demand by an estimated 200 million tons—or twice the annual output of the entire U.S. steel industry. That means that despite the broadest round of steel tariffs in almost 20 years, the carnage is bound to continue.

Lost in this extraordinary tumult, however, is something even more extraordinary: A new American steel industry is rising from the wreckage. In a whirl of deals, an emergent Big Three—minimill king Nucor Corp., upstart International Steel Group Inc. (ISG), and a resurgent U.S. Steel—have acquired the assets of a half-dozen bankrupt peers, consolidating one of the most stubbornly fragmented industries in basic manufacturing. The trio now accounts for nearly half the steel made in the U.S. and two-thirds of sheet steel and other flat-rolled metal that go into vehicles and big-ticket appliances. The three are also going abroad, bidding for mills in Europe and Asia and investing in ventures in South America and Australia. And each wants more. Declares U.S. Steel Chairman and Chief Executive Thomas J. Usher: "This is only the beginning."

Moreover, thanks to a trailblazing deal with organized labor, U.S. Steel and ISG could soon transform themselves into low-cost manufacturers, enabling each, like Nucor, to reliably



SHAKEOUT Under CEO Usher, U.S. Steel is slashing its workforce in an effort to transform itself into a low-cost producer

TODD BUCHANAN

make money in the rough world of international steel. "There is absolutely no doubt that U.S. Steel and ISG will be significantly more competitive with Nucor and globally," says Nucor CEO Daniel R. DiMicco. ISG, in fact, is well on its way. The Cleveland-based company, which began only in early 2002 with the idled assets of bankrupt LTV Corp., exported 300,000 tons of hot-rolled steel to China in April—at a profit. Thanks to personnel cuts, ISG is producing a ton of steel per employee every hour, down from 2.4 hours at LTV. "It's a sea change for the industry," says ISG Chairman Wilbur L. Ross Jr.

To be sure, the ascent of the Big Three is likely to be traumatic for employees and competitors—and a challenge for customers and management alike. Still, the industry restructuring may turn out to be an epochal event, possibly ushering in an age of stability and an end to trade protectionism. Over the next decade, many industry analysts predict, consolidation could leave just six or seven global steel companies standing. By getting into the game today, America's Big Three have a good chance of making it into the lineup.

Already, many have been hurt in the shift. Some 200,000 retirees and dependents have seen their health-care benefits annulled as a result of U.S. Steel's $1.12 billion takeover of bankrupt National Steel Corp. in May and ISG's acquisitions of LTV and Bethlehem Steel Corp. The government's Pension Benefit Guaranty Corp. has picked up these obligations, in the largest such transfer in the agency's 29-year history.

Now, to bring labor expenses down further to Nucor's rock-bottom level, the two are planning to eliminate 9,000 more jobs by yearend. Moreover, by boosting productivity and capacity, the three will only intensify the industry shakeout, turning up the heat on other steel producers to match them.

BIG STEEL'S TRUE METTLE

As the wheezing industry is revived through blockbuster mergers, a Big Three is emerging: International Steel Group, Nucor, and U.S. Steel. But to succeed, this trio must:

GIRD FOR COMPETITION

Tariffs are scheduled to expire by early 2005, exposing domestic steelmakers to another surge in imports and lower prices.

BOOST PRODUCTIVITY

Even with pension concessions from organized labor, the Big Three must keep up the push for greater efficiency from top to bottom.

IMPROVE THEIR FINANCES

All three have piled on debt to buy bankrupt rivals. If they're not careful, the IOUs could eat into asset upgrades.

INTEGRATE NEW ASSETS

The troika must integrate a hodgepodge of acquired mills, new workers, and unfamiliar operation systems.

From a customer's perspective, pricing may be another downside. Steel users could be pinched as the Big Three exploit their bulked-up size to tinker with output and shore up prices. Navistar International Corp., for instance, can no longer get the discounts it once did, reports Robert C. Lannert, vice-chairman and chief financial officer. Instead, the truck maker is looking into piggybacking its 80,000-ton-a-year steel order with longtime business partner Ford Motor Co. or lining up a permanent supplier from outside the U.S. Michael J. Wuest, chief procurement officer for Oshkosh Truck Corp., which buys more than 100,000 tons of steel annually, also laments the new order. "You're never going to see the buyer's market you once did," he says.

Inside the Big Three, management challenges are also daunting. Each one has to mesh operations and whack expenses without letting quality or reliability slip. The troika must also contend with a three-year long slide in U.S. manufacturing, which is sapping demand. Then there is the matter of surviving in a world marketplace without government help. After lobbying by all three companies, President George W. Bush imposed tariffs on steel imports in March, 2002. The barriers will be lifted by early 2005 at the latest, exposing domestic producers once again to an upsurge of foreign steel. And given the drubbing the President took for the tariffs, it's unlikely he will ride to the industry's rescue if it founders again.

Some of these issues, including the grief of laid-off workers and impoverished retirees, cannot easily be redressed. But other challenges may be less troublesome than they first appear. Take the recently imposed tariffs. To begin with, imports from Canada, Mexico, Brazil, South Korea and other nations were exempt. In addition, the White House has granted hundreds of

exclusions, so that the tariffs now apply to only 20% of imports. The tariffs also have been reduced, as they phase down toward zero. "It's been kind of neutered," says Leo J. Larkin, a metals industry analyst with Standard & Poor's.

Post-acquisition integrations, too, could go more smoothly than many predict. Nucor, of course, is famous for going head to head with even low-wage producers, thanks to a corporate culture that enshrines productivity. Lately, U.S. Steel's management is showing the same knack. Taking what Usher concedes was a big gamble, the company went overseas for the first time and spent $475 million for Slovakian steelmaker VSZ in 2000. Today, the facility is U.S. Steel's most profitable and the largest producer of flat-rolled steel in Central Europe. ISG's Ross, meanwhile, is a storied contrarian investor who has made a fortune by salvaging bankrupt assets. And to better his chances with ISG, he has enlisted a Nucor alum as chief executive. Investors seem to approve: Shares of U.S. Steel and Nucor both have climbed 20% in 2003. (ISG is privately held.)

Oddly, a shakeout has been prescribed as the cure-all for the American steel industry for decades. Elsewhere, consolidation did take hold. Over the past decade, steel producers in Europe and Japan have merged into just a handful of giants. Most other basic industries in the U.S., too, are now dominated by a few titans. Yet U.S. steelmakers remained a multitude of bit players slugging it out against each other. As a result, they've often been no match for foreign companies that, with so much excess capacity, have commandeered 20% the U.S. market.

So why the frenzy of dealmaking today? The catalyst, all agree, was the abrupt shutdown in late 2001 of LTV, then the nation's No.4 steelmaker. Overnight, 7,500 people were out of work and 82,000 retirees and dependents were on their own. The losses jolted the United Steelworkers of America. Before, the union had resisted every attempt to reduce pensions or retiree health-care benefits. And for good reason: After decades of cutbacks, the retired outnumbered active employees at old-line companies by an average of 8 to 1. But after LTV's failure, the union leadership concluded that it had better do everything it could to keep other steelmakers from liquidating, too, or it would have no dues-paying members at all.

BETHLEHEM STEEL: *ISG acquired its assets in May*

It takes two to make a deal, however, and no one wanted to bargain with the steelworkers—until Ross came along. He told the union he would restart LTV, but on two conditions: The steelworkers would have to let him off the hook for the $5 billion in retiree obligations had helped sink LTV; and they w have to consent to a new contrac lowing him to operate the facilities far fewer employees. In exchange profit sharing, a defined-contributio tirement plan, and no pay cuts fo hired workers, the union agreed.

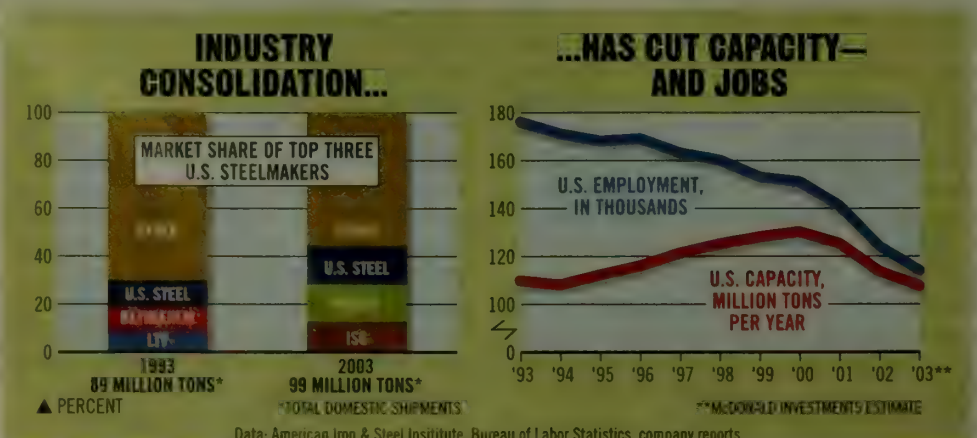
closed on his $262 million acq tion in April, 2002, through his vate-equity investment firm, Ross & Co. And with Nucor eran Rodney B. Mott as CEO began restarting the former mills last summer.

Using its new labor contra a template, privately held ISG picked up the assets of Acme als Inc. for $65 million in late Then, in early May, ISG follo up with its biggest takeover paying $1.5 billion for the as of Bethlehem Steel, the nat third-largest steelmaker. With ISG leapfrogged U.S. Steel in mestic capacity to rank second hind Nucor. "He accomplis what those of us in the indu couldn't, given all the baggage carry," notes Robert J. Dar former chairman and CEO of land Steel Industries Inc. and a director at U.S. Steel.

Adopting a growth-by-acq tion strategy, Nucor also has trawling bankruptcy courts for stee sets. Through its steady rise to the of the American steel industry, Charlotte-based manufacturer had all of its facilities. But in late 200 snatched up two insolvent minimil vals—Trico Steel Co. for $117 mi and Birmingham Steel Corp. for million—and in March it paid $35 mi for a minimill in Arizona that N Star Steel Co. had shuttered. Wit new assets, Nucor is expected to r $6 billion in sales in 2003, up from billion last year, with steel shipm topping 16 million tons and profits ting $105 million.

As its rivals began passing it U.S. Steel got busy, too. In additio purchasing National Steel's assets, Steel agreed in March to pay $23 lion for a second European steelma in Serbia, and is now one of two f ists for Polskie Huty Stali, Poland' ant steelwork, which is being pr tized. If U.S. Steel wins the auctio will be No.3 in capacity, up from s today and 11th a year ago, with sales climbing to $10 billion, fro billion last year.

Of the new Big Three, U.S. Steel have to do the heaviest lifting. The



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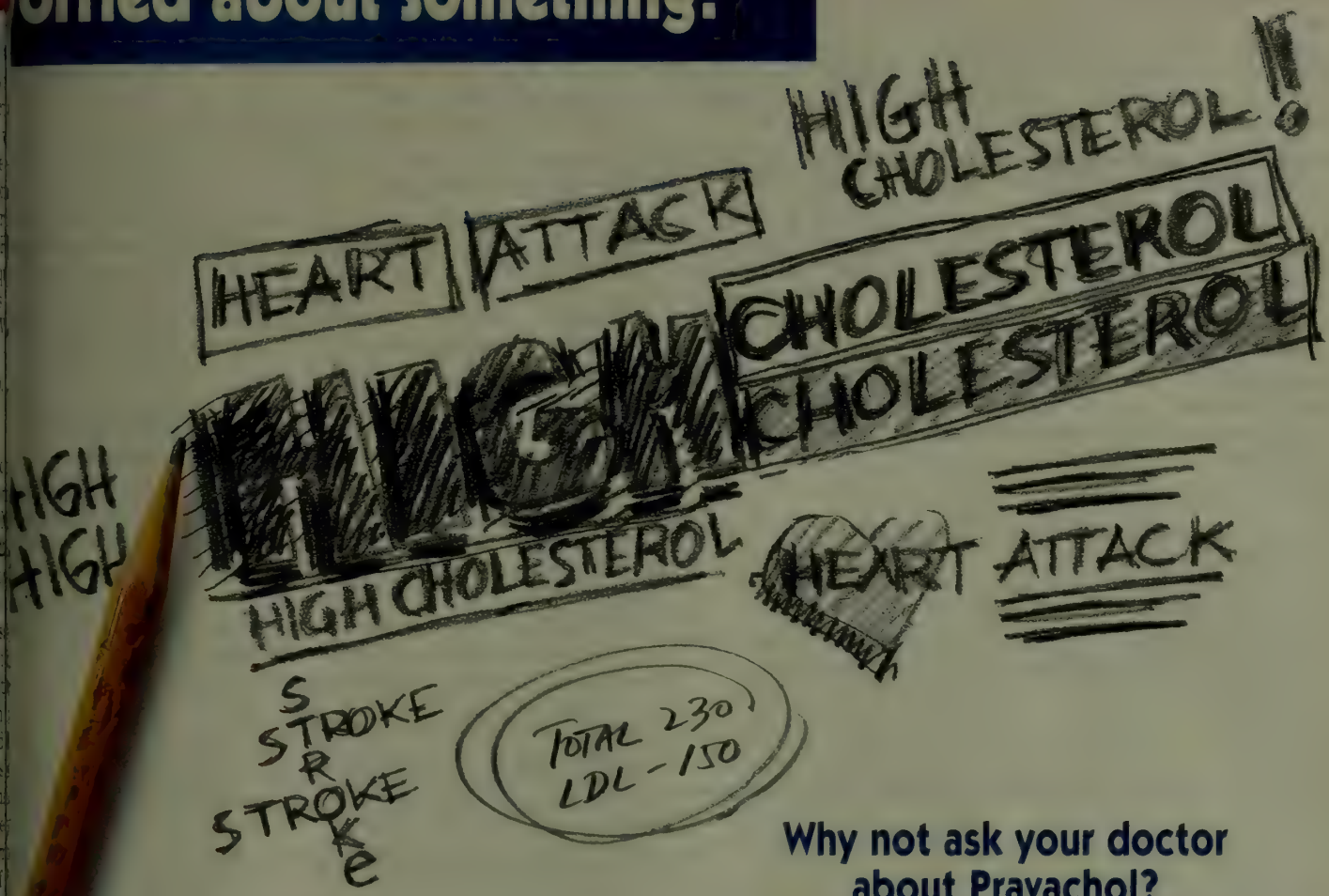

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*Pearson et al. *Arch Intern Med.* 2000;160:459-467.

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2) Rarely, patients taking PRAVACHOL have experienced serious muscle damage. It is important that you know the early signs and symptoms of muscle damage. (See **"What are the possible side effects of PRAVACHOL?"**)

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Some people may need to stop taking PRAVACHOL comple or for a long time (see **"What are the possible side effects PRAVACHOL?"**).

What activities should I avoid while taking PRAVACHO

- **Do not get pregnant.** If you do, tell your doctor right away.
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What are the possible side effects of PRAVACHOL?

You should be aware of the following serious side effects:

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  - — muscle problems like weakness, tenderness, or pain that d have a good reason for happening to you.
  - — a fever or you feel more tired than usual.
  - — passing brown or dark-colored urine.
- **Liver damage:** Rare cases of liver function abnormalities h been reported with PRAVACHOL. Your doctor may do blood t to check your liver before you start taking PRAVACHOL, and w you take it.

Common side effects with PRAVACHOL are rash, upset stom muscle ache, and headache.

These are not all the possible side effects of PRAVACHOL. For m information, ask your doctor or pharmacist.

Talk to your doctor or pharmacist if you think you have side eff from taking PRAVACHOL.

General information about the safe and effective use PRAVACHOL.

Do not use PRAVACHOL for a condition for which it was prescribed. Do not give PRAVACHOL to other people, even if have the same symptoms that you have. **Keep PRAVACHOL an other medicines out of the reach of children.** This p summarizes the most important information about PRAVACHO you would like more information talk with your doctor. You can your doctor or pharmacist for information about PRAVACHOL th written for health professionals.

What are the ingredients of PRAVACHOL?

Active Ingredients:

The active ingredient in **PRAVACHOL** is pravastatin sodium.

Inactive Ingredients:

The inactive ingredients in **PRAVACHOL** are croscarmellose sod lactose, magnesium oxide, magnesium stearate, microcrysta cellulose, and povidone. The 10 mg tablets also have Red F Oxide; the 20 mg tablets and the 80 mg tablets also have Ye Ferric Oxide; the 40 mg tablets also have Green Lake Blend (I Yellow No. 10-Aluminum Lake and FD&C Blue No. 1-Alumi Lake).

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D3-B001CI-06-03

Issued June 2

y carries a salaried workforce of
0, plus 1,700 brought over from Na-
al Steel, and a seven-tier organiza-
al structure. While that white-collar
roll is down from 27,000 in 1983, Nu-
gets by with no more than 1,700
production employees and has just
layers between CEO DiMicco and
shop-floor worker. ISG is down to
levels, too. Moreover, U.S. Steel
have to root out what even Usher
racterizes as "an overseer's mentali-
inbred for a century. "U.S. Steel
the potential to regain a lot of
ngth," states Daniel A. Roling, a
als analyst at Merrill Lynch & Co.
t are they stronger? Not today." In-
d, Roling estimates that U.S. Steel
lose $26 million in 2003.

Usher & Co., however, say they will
vail—and sooner than outsiders
ht think. By yearend, the company
s to weed out one of every five ad-
istrative employees. Seniority won't
essarily be the deciding factor in
will go. "The people who are left
be people who can adapt to the
model," Usher vows. The others
prefer yesterday's command-and-
rol mind-set, he adds, "will enjoy
r retirement." The inner circle also
ws no doubts about the company's
rewithal to pay its bills. A junk-
le debtor, it already owes $175 mil-
a year in interest, at rates of up to
5%, and its long-term debt of $1.9
on is bigger than its market cap.

U.S. Steel has no big debt pay-
its due before 2008. And if it needs
e cash, it has $600 million in re-
ing credit as well as coal mines and
r noncore assets it can unload.

ll told, U.S. Steel figures that by
end it will be able to chop $550 mil-
from its pre-acquisition expenses of
5 billion. That would lower its
keven point by $30 a ton and, based
analysis by Morgan Stanley & Co.,
its 2004 earnings by $310 million.
ng, too, sees better earnings in 2004.
bumped his price target for U.S.
l to $20 a share, from $15.50 today.

he race isn't over, of course. ISG's
s, in partnership with Goldman,
hs & Co., is bidding $250 million for
krupt Kia Steel Co. of South Ko-
Nucor, meantime, is investing in
t ventures in Brazil and Australia.
U.S. Steel execs are checking out
r domestic steelmakers that already
bankrupt or close to it, including
d's former in-house supplier, Rouge
ustries Inc. All of which lends cre-
ce to the idea that within several
rs, the international steel industry
ld be down to a half-dozen giants.
the moment, hardly anyone is ruling
Americans out.

By Michael Arndt in Pittsburgh

COMMENTARY

By Mark Hyman

THIS WAITING GAME IS A SMART PLAY

For the past two seasons, the future of the Montreal Expos has been hanging like a pop-up in the thick air of a July afternoon. But is Major League Baseball now ready to act?

Commissioner Bud Selig is scheduled to get a report from MLB's relocation committee at the All-Star Game in Chicago on July 15, which has prompted speculation that the owners may be ready to transplant the Expos to Washington, D.C., Northern Virginia, or Portland, Ore.

But don't count on a decision this week, or even this year. Here's why waiting would be the smart play:

■ With valuations in a spiral, only desperate sellers (read: AOL Time Warner Inc., owner of the Atlanta Braves) are pedaling franchises. "The last two years have been the worst in recent history for selling a sports franchise," says Marc Ganis, president of Chicago-based SportsCorp.

Some of the 29 MLB owners, who collectively own the Expos, believe the team could fetch $200 million to $250 million when the economy comes back. So there's no reason to fall into the same trap as Walt Disney Co., which unloaded the world champ Anaheim Angels in May for a bargain $180 million. Besides, the low-payroll Expos eked out a $300,000 profit last year, and this season revenues should be higher.

SMOOTH MOVES

Like Orlando Cabrera scooping up a ground ball, MLB needs to scoop up a buyer for the Expos—but not right now

■ Public dollars for new stadiums are scarce, raising doubts about the palatial ballparks suitors are promising. In Washington, which would provide $339 million in public money for a $421 million facility, Mayor Anthony A. Williams was counting on a $4.5 million-a-year tax on players. MLB has told him the tax won't fly. And Williams and MLB are at a standstill over his insistence that the franchise be awarded to Washington before stadium plans go forward. MLB also has encouraged Northern Virginia investors to increase public spending for their ballpark.

■ The line of ultra-rich investors waiting to buy the Expos is painfully short. Portland has been trying for years to secure Nike Inc. founder Phil Knight or Microsoft Corp. billionaire Paul Allen as lead investor. For now, its bid lacks any owner.

Northern Virginia has a large buyers group, but some wonder about the financial muscle of the lead investor, former telecommunications exec William L. Collins III.

The Washington group, led by GOP insider and Bush family friend Fredric V. Malek, has the money and connections. But baseball sources say Peter G. Angelos of the Baltimore Orioles has vowed not to let fellow owners forget Malek's role in a Nixon Administration controversy. As a Nixon aide, Malek counted Jews working at the Bureau of Labor Statistics.

With more questions than answers, MLB owners may likely decide the best decision now is no decision. This time, that might be the right one.

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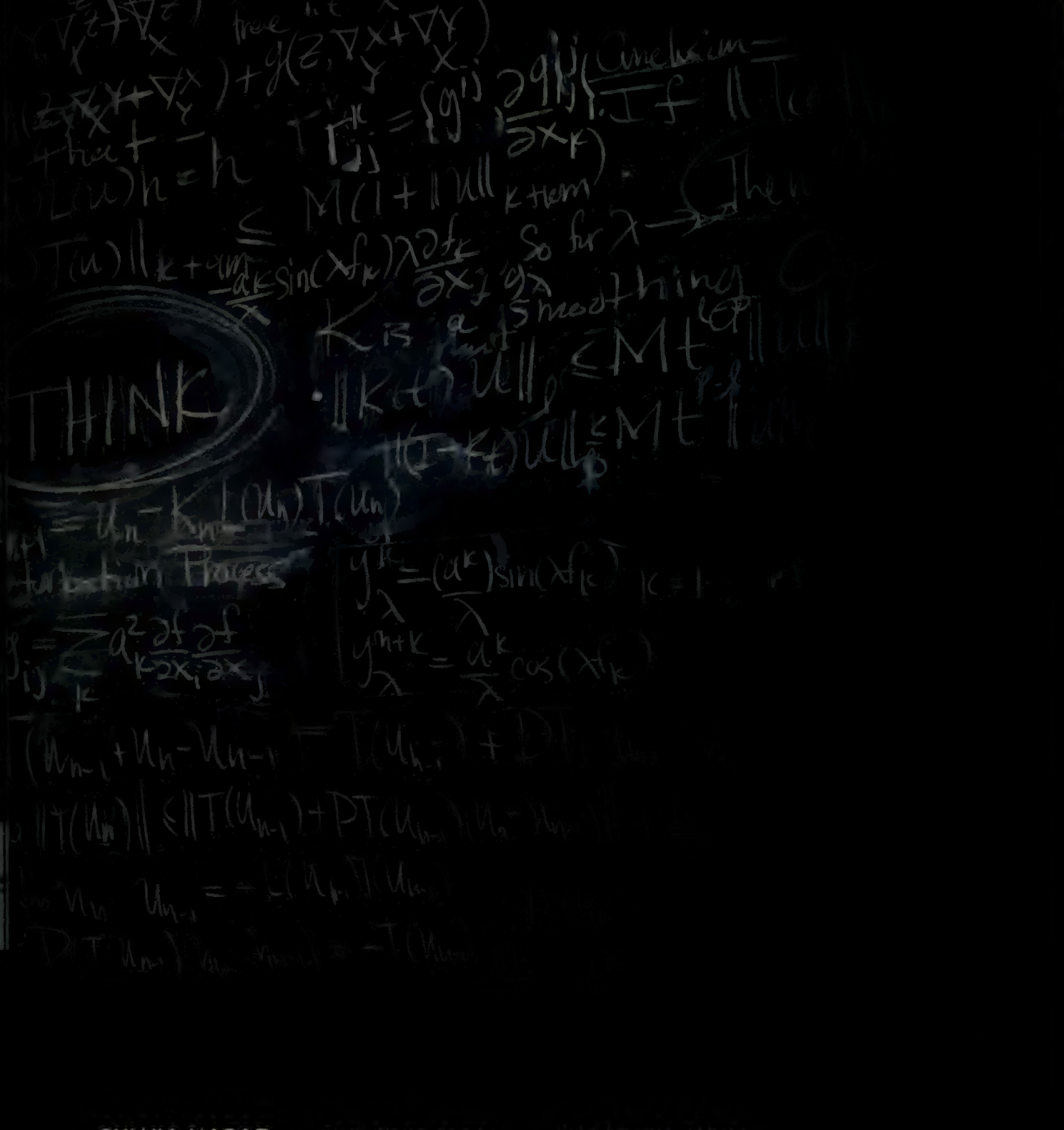

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THE DEMOCRATS

WHO'S WINNING THE INVISIBLE PRIMARY?

Keep your eye on three indicators–organization, fund-raising, and buzz–for the probable Dem nominee

Democratic pollster Anna Greenberg has some advice for Presidential candidates and campaign-watchers alike: Don't pay too much attention to the early polls. "At this point," she says, "they pick up nothing but name recognition."

So if nationwide surveys about the nine Democratic hopefuls for 2004 are unreliable predictors, how do you figure out what's going on six months before the first votes are cast in the Jan. 19 Iowa caucuses? Who's real? Who's delusional? Who'll be a footnote a fortnight into the new year?

There is a way. The Democrats are already sweating through an invisible primary that could well determine the nomination. Indeed, political veterans are closely monitoring three indicators that are reliable oracles of political fortunes: fund-raising, organization, and buzz.

In the quarter-century since Presidential fund-raising has been disclosed publicly, the eventual nominee has dominated at least one leg of the invisible primary. If that holds true for 2004, it's good news for former Vermont Governor Howard Dean, Massachusetts Senator John F. Kerry, and Missouri Representative Richard A. Gephardt. North Carolina Senator John Edwards is hanging on by a thread, as is Senator Joseph I. Lieberman of Connecticut. And right now the forget-about-it crowd includes Florida Senator Bob Graham, community activist Al Sharpton, Ohio Representative Dennis Kucinich, and former Illinois Senator Carol Moseley-Braun.

The most surprising underachiever is Lieberman. Despite a Gallup Poll in June that put him atop the pack with the backing of 21% of Democratic-leaning voters, the 2000 Vice-Presidential nominee has come up short in the invisible primary, a victim of high expectations. "He hasn't raised the money that the press thought he would raise," says St. Mary's University political scientist Andy Hernandez.

If poll-leader Lieberman isn't d
well, who is? Dean, who scores a s
7% in the national Gallup Poll, rake
more than $7.5 million in the sec
quarter—including a record-setting
million haul on the Internet. T

DUKAKIS: WHY B IS VULNERABLE

Michael S. Dukakis, who in
battled a candidate named
Bush, has been out of elect
tics since 1991. Now 69, the form
achusetts governor is vice-chairm
Amtrak board and a Distinguish
Professor at Northeastern. He is
fervent supporter of Senator John
Kerry, his lieutenant governor in
ly 1980s. On a warm summer aft
Dukakis sat down in his small o
Northeastern's Boston campus to
with BusinessWeek's *William C.*
about the 2004 Presidential conte

ed the hefty $7.4 million gathered Edwards in the first three months he year, 63% of it from fellow yers and lobbyists, according to the partisan Center for Responsive Pol-. Also in the money is Kerry. Even nout help from the fortune of his , Teresa Heinz Kerry, he has $11 ion in the bank—the t of any contender.

f history is any guide, one hose three men will be 2004 nominee. In five of past six primary seasons, Democrat with the rest cash balance on June he year before the elec—or the most prolific ear- fund-raiser—went on to ure the nomination. The exception was Bill Clin- who entered the wide- n 1992 race in the fall of after Mario Cuomo of w York opted out.

o early money is likely to vital—even more so be- se of the Democratic Par- front-loaded primary cess. Without a large pool ash, a candidate making blash in Iowa or the Jan. New Hampshire primary will not be to crisscross the country and buy ads for expensive second-wave show- ns in delegate-rich states such as higan and California. And plenty of en will be needed to respond to an cipated $200 million-plus Republican ault on the presumptive nominee.

he compressed primary season—ething party leaders devised to id a bloody and divisive fight—also es a premium on campaign organi- on. One beneficiary is Gephardt, who assembled some of Washington's brightest political minds. And he can count on unions for grassroots muscle.

Team Gephardt will get a run for its money from the Kerry Crew, which is rich with veterans of the 2000 Gore campaign, including strategist Bob Shrum and grassroots organizer Michael Whouley. Gore campaign manager Donna Brazile, who is neutral in the '04 contest, says Kerry "has the Cadillac of staffs.... [They] know how to slug it out in a knock-down, drag-out process."

And a slugfest is just what the '04 race could become, especially if Dean's insurgency continues to pick up steam. The outspoken Vermonter, who regularly proclaims himself leader of "the Democratic wing of the Democratic Party," has become the darling of liberal activists. For example, he swept to victory in a June 14 straw poll at the Wisconsin state Democratic convention with nearly four times the support of second-place finisher Kerry. And he was the clear favorite of a June 24-25 virtual primary sponsored by the liberal Web group moveon.org.

Using the Internet as an organizing tool, Dean has gone from a staff of six and $157,000 in the bank on Jan. 6 to a database of 180,000 people, including 70,000 contributors. Another sign of organizational muscle: On July 7, Dean became the first candidate to qualify for federal matching funds after collecting at least $5,000 in small contributions in 20 states.

That's one more reason Dean leads in the "buzz" category. "The cocktail chatter has gone from 'Howard Who from Whoville' to 'Can this guy be the nominee?'" says Democratic consultant Dane Strother, who is not aligned with any campaign.

That remains to be seen, but Dean is learning that the buzz can be a buzz saw. After his unsteady performance on NBC's *Meet the Press* on June 22, independent Boston pollster Gerry Chervinsky concluded that Dean "would be branded another McGovern, and Bush would beat him in a landslide."

Maybe. But a half-year can be an eternity in politics, and there's plenty of time for any candidate to, in the words of former President George H.W. Bush, get "Big Mo." Chances are, however, that the man with the "mo" will be one of the leaders of the invisible primary.

By Richard S. Dunham in Washington

LEADERS OF THE PACK

Forget the early polls. Other factors are better predictors.

EARLY MONEY

DEAN Internet giving helped pull in $7.5 million in 2nd Q.

EDWARDS Torrid giving by fellow lawyers. Plenty of cash.

KERRY Even without his wife's fortune, he's the leader.

ORGANIZATION

KERRY The best organization money can buy.

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DEAN Built an insurgent campaign in six months.

BUZZ

DEAN Has shaken up the Washington Establishment.

GEPHARDT Fired up the health-care debate.

EDWARDS Surprising fund-raising prowess.

emocrats have a realis- e of unseating Presi- n next year?

..is beatable. Any of ave been in this busi- w that favorability is less. It is the reelect —if the election were orrow, would you him?—[that is key]. now where Bush that question just ve invaded Iraq? u know where his old man the [reelect] question in 1991, was at 91% on favorability? d 1991 is very instructive. In ly, 1991,...people were say- t's have a coronation." And a lks who should have thought about running against him bailed out, except for this guy in Arkansas who reads polls better than anybody else. [Bill Clinton] took a look at that 47% and said: "I can take this guy."

THE NOMINEE *in '88*

Can the Democrats counter the campaign machine built by Bush and Karl Rove?

Nothing against Rove, but every political cycle we have some genius who is supposed to be sensational. Sometimes the strategy works once, but it may not work twice. Jim Baker was a fabulous campaign manager for George Bush against me [in '88]. But 1992 was a different time, and it just didn't work.

But unlike his father, George Bush the son has moved far faster to address recession.

Even if the numbers are looking a little better, Joe Citizen is not feeling it. In my view, this has to be the most ill-conceived set of policies to revive an economy in the history of the U.S. In fact, it has nothing to do with reviving an economy. Bush was in favor of [these policies] when the economy was in good shape. [Bush economic policy can be summed up as:] Give it to the wealthy, and somehow they will invest and create jobs.

BusinessWeek online

For more with Dukakis, go to businessweek.com/magazine/extra.htm.

BRANDS

HEADED FOR THAT SHOWROOM IN THE SKY

GM's Pontiac Grand Am and Chevy Cavalier are history

When the 1957 Cadillac Eldorado Brougham hit showrooms, it commanded a then-lofty $13,000 price and more than lived up to its reputation. Only Rolls-Royce sold a more expensive car than the top-shelf Caddy, which came with chrome gauges and a stainless steel roof. "No wonder we had half the market back then," marveled General Motors Corp. Vice-Chairman Robert A. Lutz recently as he admired a gleaming '57 Eldorado. "We made better cars than everybody else."

It has been a long time since GM's cars were so prestigious. In fact, some of the auto maker's long-standing nameplates have become so tarnished by shoddy vehicles that GM is dropping them. The vaunted Eldorado was killed two years ago. Now, Lutz has the company's marketers reappraising nearly every model, from the cheapest Chevy compact to the priciest Caddy. If a name carries baggage, such as the weak Pontiac Grand Am and Chevrolet Cavalier, GM is dumping it. Says Lutz: "When you're making a big change and you want to wipe the psychological slate clean, you change the name."

OUT

The gaudy, ribbed Pontiac Grand Am was a rental-fleet mainstay

Escaping the past isn't easy—or cheap. But GM is already betting billions on new designs that are intended to prove it can once again compete with Japanese and European passenger cars. The last thing GM wants to do is waste the effort on tired names that evoke a questionable past. "You have to change the product and the name in concert," says Ed Tazzia, managing partner at marketing consultant Gundersen Partners in Detroit. "If the market hears that it's the same stuff with a different name, it'll be a disaster."

The makeover moves into high gear next year, when GM launches the reengineered Chevy Cobalt. As a replacement for the entry-level Cavalier, it represents a bold attempt to move up in price and class. Lutz boasts that GM has designed the car with the style and craftsmanship of compacts like the Honda Civic and Volkswagen Golf. The Cobalt's advertising will target college graduates and stress the car's European-inspired styling and more upscale interior rather than focusing on price, say GM dealers. The goal is to land the Cobalt in the same range as the Civic and Golf, about $15,000 and up. No one pays that much for a Cavalier, thanks to hefty rebates. And by adding a high-performance Cobalt SS, Chevy will signal that it's going after the street-rod crowd that loves Japanese cars.

Next on the chopping block is the Pontiac Grand Am. In 2005, GM will ditch that model for a still-unnamed replacement that will bear a close likeness to the sleek, sporty G6 concept car that was unveiled at the Detroit auto show in January. The styling is a breath of fresh air compared with today's gaudy, ribbed Grand Am. It will be built on the same platform as the nimble-handling Saab 9-3 sedan. Pasting the Grand Am name on a car as graceful as the G6 would be a definite turn-o the young social climbers GM is s ing. Notes Wesley R. Brown, an an at Los Angeles consulting firm trend Inc.: "The only time import ers come in contact with a Grand A at Avis Rent A Car."

Renaming can be risky busines works only when car buyers are t convinced that a new vehicle repres a break with the past. Exhibit A how not to rehab a nameplate is Cadillac Catera, which GM launche 1996. A rebadged Opel Omega, w was viewed as stodgy in Europe. Catera fell as flat as a floor mat killed the name after just six years

Now, Cadillac has become a re to believe that GM—with the r cars—could shine up its image. A rolls out a whole new fleet of cool the division is weeding out old, E pean-sounding names that consur associate with big boats for the elderly, says Cadillac General Manager Mark LaNeve. The Catera has morphed into the CTS, and the next Seville will be the STS. Even the top-sel DeVille may be redubbed. But it's as simple as coming up with names. When Caddy attempted reposition itself and launched the C early 2002, it spent $150 million on ads and other marketing—up 50% f the previous year.

IN

An as-yet-unnamed model based on the sleek concept car

That's a lot of cash for a comp squeezed between huge pension lia ties and cutthroat competition. But at it another way, and it's hard to how GM has any alternative but to sp that much and more. After all, the c pany has invested $4.3 billion to Caddy's new cars bold styling and m them fun to drive. If dumping tarnis brands gives fresh new models a be chance of attracting buyers, it's the r time to take that risky step.

By David Welch in De

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COMMENTARY

By Paul Magnusson

IS A STEALTH IMMIGRATION POLICY SMART?

OPENING A DOOR
Goh and Bush inked a trade deal letting more workers into the U.S.

Should trade treaties be used to regulate U.S. immigration policies? That's the question critics are asking about the two new trade pacts the Bush Administration signed this spring with Chilean Foreign Minister Soledad Alvear and Singapore Prime Minister Goh Chok Tong. With little public discussion, the White House agreed to create new visa categories to allow thousands of professionals from each country to work in the U.S., on top of existing visas such as H1(b)s.

It's no small issue. The Administration hopes to use the new visa idea as a template for continuing trade talks with Australia, Morocco, and countries in Central America. At the same time, developing nations, led by India and China, are clamoring to make the new visa provisions available to all 146 nations in the World Trade Organization. The result could be a vast influx of foreign professionals from many low-wage nations, competing with American citizens for high-paying jobs.

This is a hasty way to go about making such fundamental changes to U.S. immigration policy. Indeed, as details of the new visas have begun to emerge, a backlash has been building, even among usually doctrinaire free-traders in Congress. Democrats and even some Republicans argue that the visas haven't been coordinated with existing laws on foreign workers. They make a valid point: Complex trade agreements, which increasingly affect the entire U.S. economy and require changes in U.S. laws and social policies, should not be considered in secret, or in isolation from all other legislation. "Trade agreements aren't just about tariffs but an increasingly broad range of subjects, and that requires openness and a broad bipartisan foundation," insists Representative Sander M. Levin (D-Mich.), a party leader on trade issues.

More broadly, the visa spat stands as the first test of the fast-track procedures Congress established last August for handling trade agreements. Under the fast-track approach, Congress must take an up or down vote on the Chile and Singapore deals, as well as on the accompanying legislation required to implement them. As a result, it can't consider the new visas on their own merits. Instead, Congress must either accept the sweeping changes to immigration law—or vote down the entire trade deal, which slashes tariffs on a wide range of U.S. exports to those two nations.

While the typically secretive nature of trade talks has obscured many details about the new visas, some specifics have come out. The pacts call for a new professional visa category that would allow as many as 6,800 college-educated workers to enter the U.S. each year—1,400 from Chile and 5,400 from Singapore. They could fill virtually any service-sector job in industries such as finance, engineering, medicine, and law. The visas also could be renewed annually with no limit, meaning they essentially would give immigrants open-ended permission to settle in the U.S.

As members of Congress learned more about the visas in recent weeks, some have begun to kick up

THE TRADE PACTS' FINE PRINT

Tentative new trade deals with Chile and Singapore create new types of visas for foreign professionals to work in the U.S. Such visas would probably:

- Let in thousands of workers in addition to those who now come in on H1(b) visas.
- Relax the H1(b) rule that says work visas may be issued only if there's a shortage of U.S. workers in a particular job category.
- Be for one year but renewable without limit. By contrast, H1(b)s expire after a maximum of six years
- Become an integral part of each pact, so that Congress can't alter them in any way or vote on them individually.

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NaViSet (DDC/CI)	Yes	Yes	Yes	Yes	Yes	Yes	Yes
No Touch Auto Adjust	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Integration Capable	Yes	Yes	No	Yes	Yes	No	Yes
LiquidView™ Software	No	No	No	Yes	Yes	Yes	No
Multimedia	No	No	Yes	No	No	Yes	No
Vacation Switch	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cable Management	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Input Interface Connectors	VGA	DVI-D & VGA	DVI-D & VGA	VGA	DVI-D & VGA	DVI-D & VGA	DVI-D & VGA

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fuss. House Judiciary Committee Chairman F. James Sensenbrenner Jr. (R-Wis.), whose committee has jurisdiction over immigration, was incensed to learn that a pact could rewrite visa law without going through his committee. He has demanded that U.S. Trade Representative Robert B. Zoellick apply tighter restrictions to them before Congress votes yea or nay. "It was very clear that Republicans on the Judiciary Committee do not like this process of changing immigration law through the fast-track procedure," says J. Robert Vastine, president of the Coalition of Service Industries, an industry group that supports the two trade deals and the visa changes.

Administration officials say they are trying hard to accommodate some of the objections. "It has been a collaborative procedure," asserts one trade official. For example, she says that the Administration has agreed to require that the new visa holders be paid prevailing U.S. wages, as in the current H1(b) visa program. But other potentially divisive points aren't yet clear, such as whether all employers must prove they cannot find qualified Americans before bringing in a foreign professional. Initially, the White House shared the terms with only a few members of Congress, mostly friendly Republicans. Critics also point out that the Administration can't substantially change anything it has already agreed to with Chile and Singapore, at least not without ripping up the entire pact.

Supporters of the new visas argue that developing nations will fill many of these jobs one way or another. "If [the U.S.] can't import people, then jobs will just be exported from the U.S.," says Kiran Karnik, president of NASSCOM, India's largest software-industry association. U.S. employers also say they stand to benefit.

Even so, something is missing in the consideration of these two trade deals: a broader and more deliberative debate about all the policies affected. Although it's rarely acknowledged, trade deals today involve substantial rewriting of social and economic policy. For that reason, they're too important to be railroaded through Congress.

With Manjeet Kripalani in Bombay

STRATEGIES

SLEEPLESS AT STARWOOD

By spiffing up his hotels, CEO Sternlicht is betting on an upscale business that may not return soon

Three years of lackluster business travel have done something that few in the hotel industry thought possible: They've made Barry S. Sternlicht, the 42-year-old chairman and CEO of Starwood Hotels & Resorts Worldwide Inc., look tired. Gone is the cocky young dealmaker who acted like the Jack Welch of hospitality—albeit with an artistic flair. "He used to be more rah-rah, in the here and now," says Starwood director Kneeland C. Youngblood. Now, Youngblood says, Sternlicht is "grappling with the future."

With war, SARS, terrorism fears, and a weak economy hobbling the industry, that's a wise move. Hotel occupancy rates nationwide were down last year to 59.3%, the lowest since 1971. The industry's revenue per available room is expected to decline for the third consecutive year in 2003. The last time that happened, Sternlicht was in diapers. And his five-year-old family of 742 hotels—Sheraton, Westin, W, Four Points, St. Regis, and The Luxury Collection brands—has fared worse than most, thanks to its heavy tilt toward upscale business travelers.

Starwood posted a first-quarter net loss of $117 million, largely due to asset writedowns, vs. a $33 million gain the year before. Hotel sales in Europe and at home should cut Starwood's debt to $4.6 billion from $5.5 billion earlier this year. It unloaded 12 U.S. hotels in July and expects to sell six more this year. Standard & Poor's downgraded Starwood's credit rating to a speculative grade in May.

Yet Sternlicht has stuck with his principal strategy: to invest for what he believes will be better times ahead. That means a heavy commitment to freshening up the dowdy 397-hotel Sheraton Hotels & Resorts chain with a Ralph Lauren-inspired decor. He has already reinvigorated Westin Hote Resorts into a chain of 118 hotels are seen as a cut above the Shera and Hiltons of the world. And he panded the ultra-deluxe St. Regis b to 11 properties worldwide. But biggest hit has been his 17 W Hote chain he started five years ago. It decor and trendy bars have attra both style-conscious business trav and local fashionistas.

Sternlicht declines to reveal the of all his planned makeovers, alth Starwood's capital expense budget year is $450 million. His level of

STERNLICHT HAS IMPRESSED INVESTORS, WHO HAVE BID UP STARWOOD STOCK MORE THAN 25% THIS YEAR

ment and portfolio mix has im-
sed investors enough to push the
k to $30, up more than 25% this
vs. 17% for the sector, giving it a
nium over Hilton. Investors are bet-
that it will benefit if the economy
s up later this year. Unlike its ri-
, Starwood owns a higher percent-
of its hotels, rather than franchising
n. That means more control over
agement and a bigger slice of any
its. "They're best positioned for a
around," says analyst Joseph Greff
'ulcrum Global Partners.

Until then, it will be a tough slog for
nlicht, who made an early fortune in
mercial real estate. "Every CEO you
to is miserable except for the ones
e housing industry," he muses while
ching on jumbo shrimp in a suite at
fashionable St. Regis Hotel in Man-
an. Business travelers are booking
days in advance, he complains, and
cost pressures are crushing. "You
k no less hard for less results be-
e of things you can't control," he
. At least there's one payoff: "I
t think anyone can say I'm just a
guy anymore."

The upscale business traveler who would boost Sternlicht's hotels, however, may not soon return. Some corporate travel has been replaced by teleconferencing and business people who do travel are more likely to opt for middle-tier properties. Mark A. Williams, president of the Association of Corporate Travel Executives, thinks some of the changes may be permanent. "If all I'm going to do is sleep, shower, and be gone, I don't need a lot of amenities," says Williams, who manages travel and meetings at PricewaterhouseCoopers. A PwC study shows that revenue per available room at high-end hotels shrank 15.1% last year and may grow only 3.4% between 2003 and 2004. In contrast, revenue at midscale hotels without food and beverage service—a category where Starwood doesn't play—contracted just 2.4% last year and may grow 4.1% this year.

Starwood's rivals certainly aren't banking on the high end. These days, hoteliers are more apt to woo big groups and tourists with discounts. Says Hilton spokesman Marc A. Grossman, "the independent business traveler, who is the least price-sensitive, hasn't come back." Lee Pillsbury, CEO of Thayer Lodging Group Inc., an Annapolis (Md.) holding company with Marriott, Hilton, and Sheraton properties, is equally downbeat: "It used to be business travel was glamorous. Now, travel has become such a hassle, I'm not sure people who have the choice won't choose to stay home."

Sternlicht is determined to keep upgrading, despite the tough market. Repositioning Westin has been relatively easy, thanks to three factors: greater control of the properties, a brand that carried little negative baggage to start with, and inspired design that outfitted each room with everything from an all-white, duvet-covered "Heavenly Bed" to an upscale "Heavenly Shower."

Remaking Sheraton, in contrast, has proved to be hell. For one thing, says hotelier Pillsbury, "nobody was convinced it was going to make a difference or that the company was really behind it." Many U.S. hotel owners balked at paying even minimal costs for renovations in such a tough environment. About 15% of Sheraton's franchisees even opted for independence or other brands for what Starwood Chief Operating Officer Robert F. Cotter calls "design reasons." Currently, about 40% of Sheratons aren't under Starwood management contracts.

Sternlicht admits he's not quite there with his biggest brand. But he is confident he can replicate the success of W and Westin companywide. "I don't need this job," he says. "I do it for the intellectual challenge—to build a company that's the best in the business." Until that business improves, though, the brain behind the Heavenly Bed could be tossing and turning for some time.

By Diane Brady in New York and Christopher Palmeri in Los Angeles

IN NEW YORK
The W Hotel draws style-conscious travelers

RATING THE STARWOOD PORTFOLIO

FOUR POINTS

This midmarket cousin of Sheraton suffers an identity crisis and isn't even on the radar for many travelers.

B-

SHERATON

Inconsistent, tired, and often downright dumpy. Push to renovate, but franchisees are wary of the cost.

C

WESTIN

After a successful overhaul, "Heavenly" beds and showers are making this upscale brand top of mind.

A-

W

Starwood's home run. Hip, big-city hotels appeal to fashionistas and those who consider themselves cool.

A+

ST. REGIS

Fabulous service, but can a U.S. ultra-deluxe brand take off around the world?

B

(TOP TO BOTTOM) PHOTOGRAPH COURTESY OF STARWOOD. PHOTOGRAPH BY ANDREW KIST

Special Report

DIGITAL

Net hookups are spreading from the study to the living room, bedroom, and kitchen

Shortly before dawn, Richard Wollack's condo in downtown San Francisco comes to life. Shades on the eastern side of the 2,600-square-foot unit automatically lower to filter the rays of the rising sun. In the bathroom, a flat-panel TV automatically tunes to Wollack's favorite news show, piping the sound to a shower speaker. After dressing for the gym, Wollack presses a button, and his Panasonic DVD recorder spits out a disk containing TV programs downloaded overnight from his TiVo personal video recorder.

At dusk, the blinds rise in the west to display the sunset. Wollack and his wife, Sue, become urban maestros, using a master remote to orchestrate programming on a slew of large-screen plasma TVs and music systems. They can select any device by means of icons on the remote, which can also control the heating, air conditioning, and lighting. On this particular night, Wollack chooses tunes from Old Blue Eyes—No. 126 on his 600-CD player. Sinatra's voice then follows him from room to room with a click of the remote. "The wonderful thing about this stuff is it gives you access to all your entertainment—whatever you want to watch or listen to," says Wollack, co-CEO of Premier Pacific Vineyards.

Wipe your feet. You've just entered the digital home. This isn't the stuff of *The Jetsons*, or an episode of *Star Trek*. Wollack's condo is part of an Internet-driven technological wave that is rippling through houses in the U.S., Europe, and Asia. Whether it's a deluxe design such as Wollack's or a bare-bones wireless network that a student can rig up for a few hundred bucks, today's digital home represents a mitment to tearing down walls. Occupants inhabit pr rooms where data move at lightning speed. Content is able anytime, anyplace, and on whatever device the owne sires. This is a world where the couch potato lounges i living room, presses a button, and begins watching a recorded on the TiVo in the kitchen or upstairs in the room. It's a domain in which road warriors in motion open cell phones or tablet computers for access to n files stored at home on a PC.

Today's connected homes look nothing like the top-d schemes for automated houses hatched by Japanese tronics companies in the 1980s. In Japan's Platonic ideal or to the commercial Internet, all the amenities were t controlled by a central computer. In contrast, consumers t are setting up their electronics room by room to share h speed Net connections and to exchange music, video, other content. Rapid adoption of home-PC networks is sp ing development of networked appliances and features. U TiVo and ReplayTV devices to skip commercials is alr "been-there, done-that." Both companies now are im menting features that let you schedule programs thr the Internet remotely as well as stream them among u

In a virtuous cycle, cool applications are also stoking mand for home networks. There's Sony Corp.'s latest r hound, AIBO Cyber-Blue which costs $1,299 and doubles watchdog, patrolling the halls and beaming pictures to a h handheld computer. A robot vacuum cleaner, iRobot's Ro ba, is also on patrol—doing the carpets.

Unless you have a fat bank account, tying all these th

DIGITAL DREAM HOME

1 CUTTING THE CORD Wi-Fi networks move Web surfing from the study into any area of the home

2 SMART ROOMS Window shades can be programmed to rise and fall at selected times

3 IMAGES ANYWHERE Flat-panel technology brings images to almost any nook or cranny

4 MASTER REMOTES Universal remotes control heating and lighting as well as appliances

5 JUN DIS Wit TV, hom aters do videocor centers

PHOTOGRAPHS BY TIMOTHY ARCHIBALD

OMES
1
2
3
4
5

together to create a connected home on a grand scale is nearly impossible. The Wollacks spent $125,000 on their system—far less than Bill Gates's $50 million digital home, but beyond the means of most consumers, who on average are spending about $3,000 on such setups. What's more, any keeping-up-with-the-Gateses digital dream can become a nightmare as you wade through a tangle of wires—or wireless software codes—and incompatible standards. For years, such barriers have stymied the smart-home concept. Indeed, the integrated home is still somewhat akin to Middle-earth in *The Lord of the Rings*, with factions constantly on the brink of war. "Right now, all we have are a lot of digital islands in the home," says Bill Kenney, vice-president for online strategy at Sears, Roebuck & Co.

SONY'S AIBO
Security is going to the dogs with this model, with video-camera eyes that can transmit what they see to other devices in the home

What distinguishes today's digital homes from "smart homes" of the past is the modular nature of the technology. Because so many products are designed with Internet standards in mind, consumers can start out with just a few devices and build up slowly. It helps that PCs such as Dell Computer Corp.'s XPS gaming machine and Hewlett-Packard Co.'s Media Center PC are becoming entertainment-oriented, while consumer electronics are becoming more PC-like—with hard drives, screen-based menus, and built-in Net access. Piece by piece, the technology also is getting more user-friendly. That goes a long way toward explaining the explosive popularity of Wi-Fi networks, now in 11 million U.S. households.

Electronics companies understand that their wares must work together and be simple to use. That mission is facing warring factions to lay down their weapons. In June, some top-tier companies including Sony, Samsung, Philips, Nokia, and HP formed the Digital Home Working Group, which will implement guidelines allowing networked devices to work together and even interconnect automatically on the Net. "The digital home has a lot of impetus behind it and, for the first time, a lot of people pulling in the same direction," says Gartner Inc. consumer-

WHEN MONEY IS NO OBJECT

1 COOL TOUCHES This koi pond helps control climate through wind vents that open and close as the water rises or falls

2 SIMP CON For t pond and advanced features, t is keeping command simple an

electronics analyst Van L. Baker in San Jose, C

It's no coincidence that this peace pact was signed time when broadband adoption is skyrocketing. In the alone, 13% of the population has high-speed Internet nections. The trick now is sharing those connections ar PCs so people can shuttle both entertainment and work room to room. That's fairly easy once the network place, but setting it up can be brutal. "Consumers ca some of these things today, but it's very, very painful," Intel Corp. Vice-President Louis J. Burns.

For many consumers, the digital home begins in the h office. That's often where the most powerful PC resides,

COMMENTARY

By Steve Wildstrom

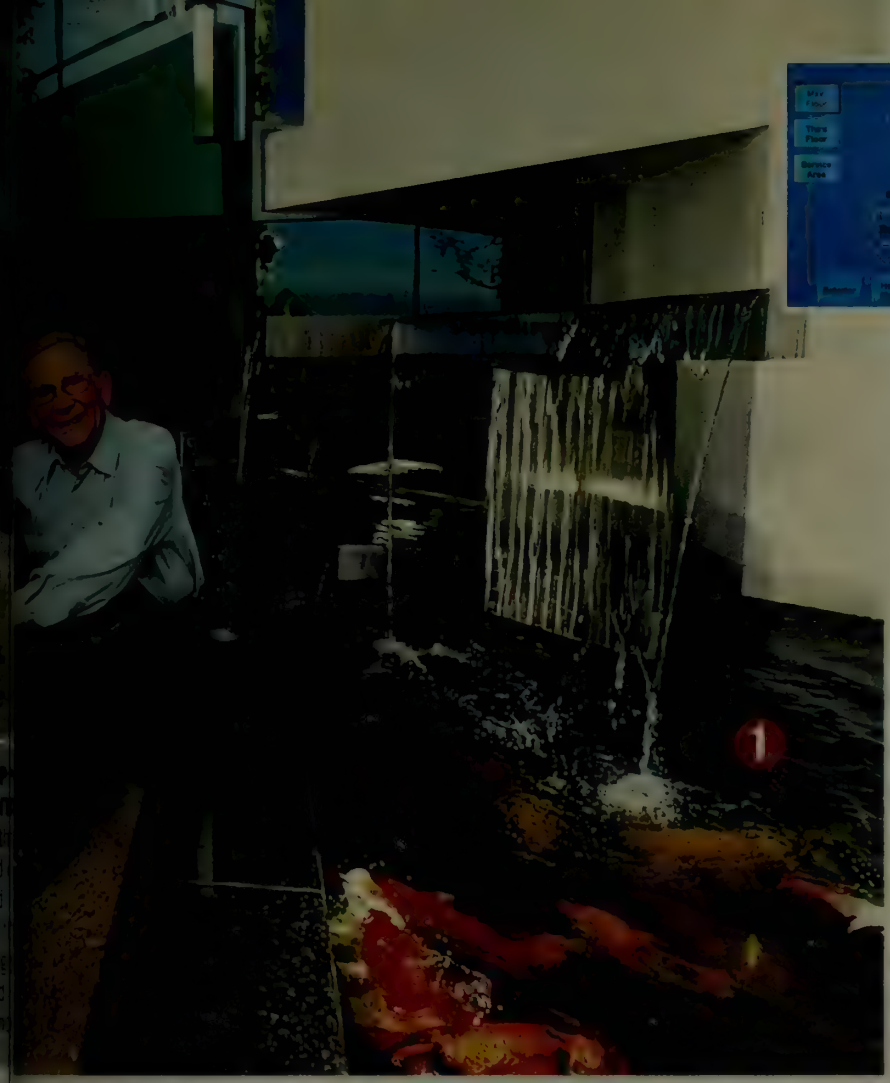
WHAT NEEDS TO HAPPEN NOW

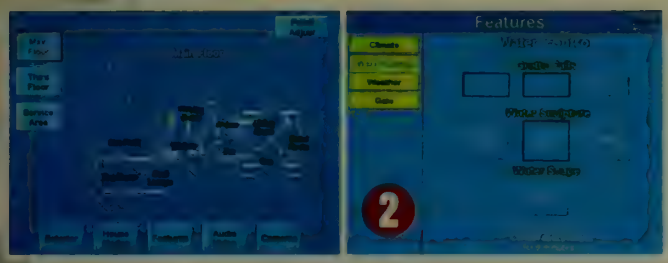
In 10 years of writing about personal technology, I have heard the digital home heralded so often that it has seemed as mythical as the unicorn. Still, I'm convinced that it is on the verge of becoming reality.

From Microsoft Corp.'s home of the future in Redmond, Wash., to Philips Research's HomeLab in the Netherlands, researchers have built prototype automated homes that apply computer technology to the needs of daily living. They're cooking up security systems using facial recognition and appliances that brew your morning coffee when they sense you're in the shower. In the 1990s, projects such as these would have involved absurdly expensive technology and an army of engineers. Now, prototypes can be cobbled together in weeks from off-the-shelf components.

There's still a vast amount of work to be done, but much of it has moved from labs to committee rooms. Engineers and lawyers now must grapple with the technical business of setting standards and mediating between consun sire for cheap entertainment a tent owners' demand for royal bulk of the challenge to indust ever, can be summed up in thr reliability, simplicity, privacy.

Nearly everyone agrees tha tainment is the gateway to the home. Consumers may be relu trust heating, cooling, or home to crash-prone PCs, but there i risk in storing music, photos, a in a central computer, zipping





still the primary location for downloading digital photos music. But the entertainment factor is quickly luring work-savvy families into the living room, where the main action is digital TV. These large-screen gizmos look and act normal sets. But they can display all manner of digital tent—and they may soon start to function like large oconferencing screens. The Consumer Electronics Assn. ects 4 million digital TVs to be sold in the U.S. this year 10.5 million in 2006.

he kitchen and bathroom are still works in progress, as panies struggle to convince consumers there is a benefit having a refrigerator that automatically orders milk when the carton is empty, or a bathroom that weighs you when you step out of the bath and scrolls diet suggestions on the mirror. Nevertheless, the ultimate goal for almost every room is to deliver what Dutch giant Philips Electronics calls "ambient intelligence." As devices get smarter, they can identify and adapt to individual users in a household, potentially making suggestions on everything from what to eat to how to dress. "Think of it as the electronic equivalent of an English butler," says Emile Aarts, vice-president and scientific program director at Philips Research Laboratories in Eindhoven. Those concepts may seem pie-in-the-sky now, but many are being tested in corporate labs—and some are nearing commercialization.

Consider Philips' Mirror TV, which was rushed from lab to market after a delirious reaction from human guinea pigs, who volunteer to hang out in the company's HomeLab test facility in Eindhoven. Installed in a bathroom or hung on a wall, Mirror TV seems just like a normal looking glass. But at the touch of a button, it becomes a flat-panel display that can show everything from traffic and weather reports to a two-minute cartoon that teaches small kids how to brush their teeth. Philips says hotels are already lining up to buy the magic mirror, which saves space while letting them show useful info to guests.

In short, the home increasingly is where high-tech is. To get a sense of some everyday applications now rolling out, *BusinessWeek* interviewed residents of digital homes around the world. Not surprisingly, we found consumers who say they crave technology, but only if it's no-muss-no-fuss. They should control the technology, not have it control them. It should "just work," make life easier, and even help free up

e house, and downloading handheld players. Making all rk is challenging. But years of balky DVD players and pro- VCRs have led consumers to too much of early systems. event, consumer electronics ne dimension of the digital are the other, and great ve been made in making them largely because of the comput- ry's embrace of standards, you a PC just about anywhere and to work. Indeed, compatibility eans that it is often easier to home wireless network than it three or four video devices to ether with any of eight possi- of cables. Computer folks are pushing the consumer-electronics industry toward standards for digital entertainment, but a dozen task forces haven't weaned the consumer-electronics gang from proprietary systems.

The primary task for the PC camp is to boost its commitment to reliability and privacy. Consumers will not put up with mysterious blue screens on their TVs or with entertainment systems that must be rebooted. And these home-entertainment networks must be made secure against hacking and theft of personal information.

Finally, the digital home needs easy access to entertainment content. The music industry has grudgingly embraced selling downloads, but it has surrounded them with a mix of proprietary software and complex limits on use that guarantee a poor consumer experience. With films, it's even worse: Studios have blocked any legal online distribution of high-quality video.

The digital home is a huge opportunity for both consumers and vendors. Digital entertainment could be the path to much broader use of digital technology in the home—but only if we get it right. Most of the technology is in place. Now is the time to speed up work on standards that have been languishing in dozens of industry task forces and working groups and get the products out there. Let the fun begin.

Wildstrom writes the weekly Tech & You column.

(TOP) PHOTOGRAPHS BY ALANLEVENSON.COM (3)

time to do something else. Here are some snapshots from the digital home:

THE LIVING ROOM *Cevdet Ugur and his wife, Sarka, had a problem. The San Diego couple's six-month-old firstborn, Torun, had never seen his paternal grandparents. Ugur's bakery business kept him local, and his parents' advanced age made it difficult for them to travel from Turkey. He looked into* PC *videoconferencing, but his parents were leery of the technology. During a trip to Best Buy Co., he discovered a solution: Vialta Inc.'s Beamer Videophone. Sold in sets of two for $500, the stylishly designed gizmos look like picture frames. Beamers are loaded with software and video chips, but use conventional phone lines to link up. Ugur set his up in the living room. A friend traveling to Turkey repeated the setup at Ugur's parents' home. After making a call, at the touch of a button, each could see the other in color video—and the quality wasn't bad. "It was basically dumb-proof," Ugur says. "They saw the baby for the first time, from thousands of miles away."*

The living room is the center of a Digital Age gold rush. Globally, consumer electronics racked up sales of $94.2 billion in the 12 months ended in May, says market researcher NPD Group Inc. in Port Washington, N. Y. The number should grow to $120 billion for the current calender year. And it's the living room that attracts most of the high-margin products. Thanks to the popularity of DVDs, consumers in the past few years have stampeded to upgrade home theaters, the large-screen TV and stereo setups that simulate a movie-theater environment. Cable and satellite companies and content providers also expect to make money selling services such as movies on demand and games through high-speed Internet connections. And PC makers hope "entertainment PCs" will perk up sluggish sales.

PCs, of course, hold gigabytes of data in the form of digital music and pictures. But more and more consumers prefer to share that content with family and friends on Net-connected TVs and home- theater setups. A survey released in June by researcher Parks Associates found that 20% of Net-connected households want to link their entertainment devices to a home network. To fill the demand, Gateway Inc. has just announced a $249 DVD player that also lets you stream music and video from your PC to your home-entertainment system. "The new space is digital multimedia," says Kurt Scherf, vice-president for research at Parks.

In the living room, fads rule. This year, for the first time, sales of digital cameras are expected to overtake film cameras, and digital music downloading is still going strong. Free file-swapping services such as Kazaa and Morpheus have millions of users online at any moment, and Apple Computer Inc.'s iTunes Music Store customers downloaded 5 million 99¢ songs in just the first eight weeks of operation. As for Vialta, maker of the Beamer videophone, the plan this fall is to release a higher-end version that turns into a digital picture frame—a device that displays preprogrammed sequences of digital photos—when it's not doing videoconferences. Coming soon: a che version that uses the TV as the picture screen.

PHILIPS' FUTURISTIC HOME LAB

1 GREETING An electronic companion called Bello greets his master at the door—and on any screen

2 GROOMING Some hotel chains are rolling out a simplified version of the Philips Mirror TV concept

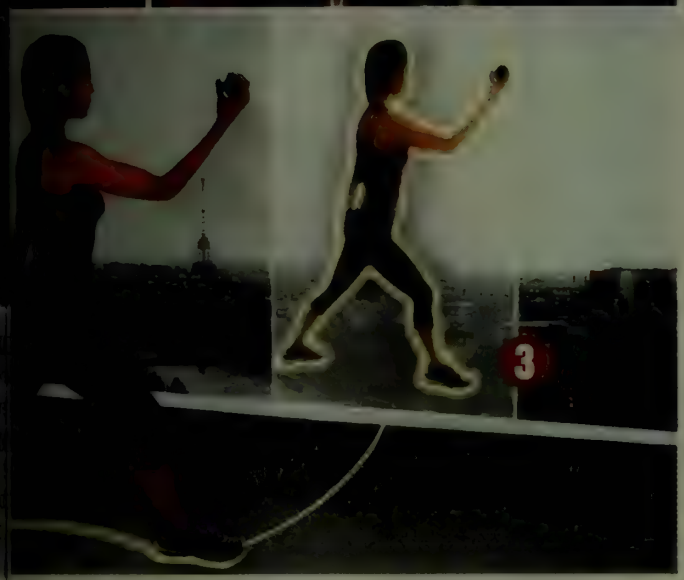
3 EX Se scr home g display health dance t

THE KITCHEN *Pardon Dory Jacobian while she tak second to phone her oven. It's all part of her quest to cre fresh, homemade meal instead of playing the fast-food f with her kids. Before heading out to work in the morning cobian can slip a made-from-scratch lasagna into Whirlpool Corp. Polara range. The device contains a pressor that keeps food cold up to 24 hours and begins ing at whatever time she programs. Better yet, at her req the Polara calls her several times during the day to re her when dinner is to be served. If 12-year-old Stuart's s game runs late, she can call her oven and command slow down or stop cooking altogether.*

A married mother of two children whose activities in soccer, baseball, basketball, ballet, and Irish step dancing cobian also works at the Boston Stock Exchange. "Every r er needs a wife," she s mulling her hectic sche Even a virtual soul mate do. She jumped at the chan take part in Mealtime, a month test sponsored by th ternet Home Alliance. It wil 20 Boston families to tes digital kitchen concept. Jac can use her Net-enabled re erator to order groceries thr Peapod Inc. Her local St Shop will deliver it within h And she can watch movie listen to music on a flip-

AN OVEN LINKED TO THE NET

Whirlpool's Polara range keeps food cold until it's programmed to start cooking. It can be operated by typed-in commands on the Internet or by tones from a cell phone.



en incorporated in the ICEBOX Web-enabled kitchen enter-ment center. "I'm just hoping they'll figure out a way to do taxes," she quips.

he kitchen remains uncharted territory on the digital tier. Yet, as many a party host has noticed, no matter how n you steer guests to the living room, they always end up he kitchen. Sears, for one, has smelled the potential in that d. It sells 38% of all the appliances in the U.S., and like ers, believes there are millions to be made in wired white ds. Sears also anticipates millions in savings if it can apply ote diagnostics to servicing refrigerators, stoves, and hing machines. In-stat/MDR predicts that 370,000 Net-nected appliances will be sold in 2007 worldwide, up from 00 in 2002.

tetailers are excited about radio-frequency identification s (RFID), which many are studying as a way to track in-tory. With RFID tags, your refrigerator can alert you if the k is getting old, or you can use your cell phone while at grocery to dial into your computer and check which ns in the cupboard need replenishing.

Many of these ideas have been around for years but have le little headway. Why? According to some manufacturers, because, when it comes to the kitchen, the folks who l the purse strings are those who carry purses: women. enage boys and early-adopter men will put up with a lot of o in setting up new technology. Women will not," says Tim ods, president of the Internet Home Alliance.

E BATHROOM *An aide helps Fusako Nishino roll her elchair into a tanklike tub. The 88-year-old Yokohama pan) assisted-living resident waits patiently as the aide s a touch panel to set the water temperature, water level, h duration, and type of herb-based soap to be used. The Sanyo Electric Co. tub fills up in 60 seconds. It then cycles through wash, rinse, and dry—much like the automatic washing machines the company also makes.*

The retired telecom employee's biggest helper is the bathroom itself. Nishino's private washroom is outfitted with a sensor-activated faucet, so there's no fussing with taps. She has a high-tech toilet with a wash cycle of its own. "Everything is so much easier for me now," she says. Soon, she could get even more help: Matsushita Electric Industrial Co., another consumer electronics giant, has developed a medical toilet that can analyze the sugar in her urine and relay the information to a doctor over the Net.

The market known as e-health may be one of the most important digital arenas of the future, as populations in developed societies rapidly age. Japan is emerging as a test bed for digital gadgetry that is designed with the disabled or elderly in mind, but high-technology medical gadgets increasingly are getting attention in America and Europe as well.

With the explosion of e-health applications, the $1 trillion health-care industry may see sweeping changes. A 2001 Harris Interactive Inc. study found that a big majority of people using the Net would like to get e-mail reminders for preventive care, follow-up e-mails after visits to doctors, and faster access to lab tests.

FILL 'ER UP
Yokohama's Fusako Nishino enjoys her bath from the comfort of a wheelchair

THE BEDROOM *Meet Jim Banks, "bed surfer." A self-proclaimed information junkie, Banks couldn't wait to buy one of Motion Computing's Tablet PCs for $2,600 last December. As vice-president for sales at Movaris, a Campbell (Calif.) consulting company, Banks loved the idea of getting rid of mountains of notepads and handwritten logs of all his meetings. When he brought his Tablet home, though, he discovered a side benefit. Instead of squirreling himself away in his home office reading e-mail and doing other work, he sits in the living room with his two children. In bed, he pages through an e-book about Jack Welch and GE and checks on the latest sports scores. "It's a great opportunity to do research, to do pleasurable stuff without getting in trouble with the wife," he says, chuckling.*

As consumers cut the cord and use mobile devices to surf the Internet, the bedroom is quickly becoming a comfortable place to lounge. And Wi-Fi is speeding the transition, extending broadband services that were originally confined to the study. In Singapore, for instance, K.O. Wong uses a Philips' iPronto—a combination Web pad and master remote for the television—to browse the Internet while her husband and 6-year-old daughter battle over watching sports or yet another Disney movie.

CLIMATE CONTROLS: *Alfred E. Mann's house is a digital oasis. The co-CEO of Advanced Bionics Corp. designed his five-acre Beverly Hills spread himself, deftly using water as a*

dramatic visual—and functional—centerpiece. The front security gates open and close using hydraulic pressure, which is more efficient and reliable than electricity. A 150-foot-long koi pond extends from the front entryway through small canals into the house and out to the backyard. When the wind whips up, a weather station on the roof sends a signal to a small dam, which automatically lifts the pond's water level so that it is flush with the house. That seals off the opening where the channel flows inside, thus keeping the wind from blowing through.

Mann also figured out how to pump excess energy generated by his house's evaporative air conditioners into a heat exchanger that warms his 140,000-gallon pool to a toasty 86F. "I can maintain the pool at that temperature without extra energy," Mann says. If the pool reaches 90F, the house automatically switches on a series of waterfalls, which cool down the pool—and wow Mann's party guests.

Most cost-conscious consumers won't plunge into automated climate control anytime soon. For now, the most popular application will be swapping entertainment content among rooms. Determined to hold costs down in this and other areas, consumer electronics companies recently announced they will collaborate on creating devices using the free Linux operating system. That's a challenge to Microsoft. But the software giant still aims to make its Windows Media 9 software the dominant scheme for protecting audio and video against piracy. Other potential players in that area are RealNetworks and Apple. Even as the jockeying continues, though, Matsushita Executive Vice-President Yukio Shohtoku says, digital homes "will happen."

As the myriad devices in the digital home evolve and acquire new capabilities, each must maintain its links to all the others under the umbrella of Internet standards. Richard Wollack understands the nature of these changes. In the 16 months since he has moved into his condo, computers have nearly doubled their processing power, and Wi-Fi has taken off. Now, he's fine-tuning plans for a 5,400-sq.-ft. second home in St. Helena, Calif. Ambient heating will be built into the floors. Wi-Fi will be everywhere. And PCs in the two houses will be networked, allowing him to share music between them, as well as remotely manage fire, alarm, and air conditioning systems. Again, his dreams far exceed the means of most householders. But even with more modest budgets, there are plenty of options available to fill the bill.

By Cliff Edwards in San Francisco, with Arlene Weintraub in Los Angeles, Irene M. Kunii in Toyko, and Andy Reinhardt in Eindhoven, Netherlands

DEALS

BIBLIOWICZ'S TRICKY PITCH

Will Sandy Weill's daughter succeed in taking her financial-planning firm public?

anford I. Weill bought company after company and now is chairman of Citigroup, the biggest financial powerhouse in the U.S. wise, his 43-year-old daughter, Jes- Bibliowicz, has shown she's no h in the acquisition game. Over the four years, she has spent about million to acquire 138 financial- ning firms on behalf of her company, onal Financial Partners.

ow, she faces the acid test: per- ling investors that her collection of s, which generated $361 million in nue last year, is worth top dollar. In , NFP made its first filing for an ini- public offering, but a value for the and a timetable for marketing it yet to be announced.

he offering will be closely watched Wall Street, and not just because is perhaps Bibliowicz' best shot at blishing her own name apart from larger-than-life father's. Her com- , where she's chief executive, is ed by big-time money: $125 million Apollo Management, the shrewd out shop run by '80s dealmaker D. Black. More significantly, NFP is ing the same customers as virtually y bank, brokerage firm, and insur- company in the country: high-net- h individuals, the mother lode of and commissions.

Bibliowicz, who wouldn't comment d of the IPO, won't get a cheery re- ion from the rest of the industry, that's probably the least of her wor- She must convince investors that financial planners will work hard eliver steadily growing earnings after they've sold to NFP. With- planners acting as if they're still ers, NFP's stock could sour. Without veet stock, the planners could lose rest and bolt. More than a dozen panies have tried and failed to roll ig groups of financial advisers, says rles "Chip" Roame, managing prin- l at Tiburon Strategic Advisors. e has gotten this far. The problem, Dennis Gallant of consultants ulli Associates Inc., is that advisers to be fiercely independent entre- neurs who like to work for them- es. "It's like herding cats," he says. ndeed, Bibliowicz, who honed her sell- skills at her dad's Smith Barney mu- fund business and at Prudential Se- ties Inc., has found that enlisting planners is harder than she expected. She told *BusinessWeek* in 1999 that NFP would acquire 300 firms by the time it went public in three to five years. Today, NFP has only 124 firms (it jettisoned or merged 14 of the firms it bought), and that's after wooing planners with some $40 million in bonus stock options. Bibliowicz, who runs the operation from a Manhattan office with a Central Park view and an interior designed by her architect husband, Natan Bibliowicz, deserves some slack because of the stock market's plunge since she took the job, says Roame. Some planners who want to sell are likely waiting for their business to improve so they can get a better price, he says.

But even in a good market, NFP might find recruiting tough. NFP's prospectus boasts that its planners are "independent" and offer their clients "unbiased solutions." At the same time, NFP sounds far from objective in describing planners as valuable "distributors" for "financial-services product manufacturers," companies such as AIG American General, American Funds, and Travelers Life & Annuity, a subsidiary of Weill's Citigroup. "When you talk about products, people like me cringe," says Kurt Brouwer, a planner in Tiburon, Calif., whose revenue comes from fees he charges for his services rather than commissions for selling products. For him, "products" connotes investments that are sold whether people need them or not, to generate commissions. Brouwer talked with Bibliowicz about NFP but says he had no desire to sell because he thought it might compromise his clients' interests.

Bibliowicz and her partners at Apollo have set a lofty price for the IPO. In 15 purchases of firms in January and February, they figured NFP's stock at $19.38 a share, valuing the company at $613 million—a sky-high 53 times 2002 net income of $11.6 million. Depending on the market's mood, Bibliowicz may be able to persuade institutional investors to ignore some noncash expenses and accept NFP's profit as $29 million. That would bring the price-earnings ratio down to 21, around the average for established brokerages and money managers. Still, that would be a stretch for an upstart, especially when investors see that revenue growth at firms NFP has owned for a year averaged only 6% in 2002—nothing special when the long-term revenue growth rate for financial planners is pegged at 5% to 7%.

The key for Bibliowicz is to keep planners motivated. One of her tactics: Make the first 50% of any shortfall in a planner's earnings target come out of his or her own pocket. To encourage planners to exceed targets, NFP pays fat bonuses. And the planners have a huge incentive to help the shares do well because they've taken half of their sale proceeds in stock and own 49% of NFP. If the shares sink, the planners are likely to quit when their contracts expire, typically in five years.

What's more, Apollo could also get restless. It owns 39% of NFP and has been a patient investor for four years. Without a successful IPO and the chance to sell some of its holdings, Apollo may look to sell to an insurance company or a bank. That could alienate planners, who fear they may be forced into selling just one company's products.

For Bibliowicz, who earned $1.1 million in salary and bonus last year, her reputation is more at risk than her money. She owns only 48,600 shares outright, with options on 500,000 more at $10 a share, about half NFP's last appraisal. If she fails with the offering, well, Sandy had some setbacks, too.

By David Henry in New York

NFP'S PLAN

National Financial Partners buys and manages financial planners—a strategy many others have tried and failed at. Its IPO would be a first in the field

REVENUE*
$361 million

NET INCOME*
$12 million

ADJUSTED NET INCOME**
$29 million

FIRMS BOUGHT
138

SALESFORCE
1,200

* 2002 figures

** 2002 earnings before amortization of intangibles, impairment loss, and depreciation

Data: NFP draft prospectus

P calls its advisers "independent" and "unbiased" and o "distributors" for "financial-product manufacturers"

Cover Story

THE MOST POWERFUL TRADER ON WAL STREET YOU'VE NEVER HEARD OF

Meet Steve Cohen. Even his enemies admit he's the best stock trader around, routinely trouncing the market with his $4 billion hedge fund. Just how does he do it?

By Marcia Vickers

A gunmetal-gray BMW 745 Li sedan slips out of Steven A. Cohen's 14-acre walled estate. The chauffeured car races along the winding backcountry hills of ultrawealthy Greenwich, Conn. At around 8 a.m., it powers into the parking lot of SAC Capital Advisors. Cohen quickly emerges and darts into the front entrance of his gleaming steel and terra-cotta-slabbed Stamford (Conn.) headquarters. His driver swings the car around to the back and parks in a space with a simple reserved sign amid a sea of testosterone-exuding cars belonging to his trad Mercedes S600s, Lexus sport-utility vehicles, and Por Carrera 4s. Cohen will soon be sitting at what one trader "command central"—his desk with its numerous scre perched in the midst of a football field-length trading floo the next few hours he is likely to earn several million do

Cohen, 47, is the most powerful trader on Wall St you've never heard of. The founder of SAC Capital Advi a highly secretive and stupendously successful $4 bi group of hedge funds that bears his initials, is considere be a market genius by even his harshest critics. His firm tinely accounts for as much as 3% of the New York Stock change's average daily trading, plus up to 1% of NASDAQ's—a total of at least 20 million shares a day. while most of his rivals struggle to keep their trading down, "Stevie," as he's known on Wall Street, is one of few to pay full freight. He hands over about $150 milli year in commissions to Wall Street, making him one of it largest customers.

The payments grease the superpowerful information chine that Cohen has built at SAC. The firm's credo, says a mer SAC trader, is to "try to get the information before one else." The torrent of commissions wins Cohen the that often makes him privy to trading and analyst inform

COHEN PAYS $150 MILLION A YEAR IN COMMISSIONS T BROKERS, WINNING HIM THE CLOUT THAT MAKES HIM PRIVY TO TRADING AND ANALYST INFO AHEAD OF RIVAL

ahead of rivals. Says one analyst: "I call Stevie personally when I have any insight or news tidbit on a company. I know he'll put the info to use and actually trade off it." Cohen expects to get the first call when an analyst upgrades or downgrades a stock, and if he doesn't, offenders have been known to get a tongue-lashing from SAC traders. Brokers lavish plenty of other privileges on him. For instance, SAC was a big beneficiary of allocations of red-hot initial public offering shares during the Internet boom, according to several former SAC traders.

Cohen manages less money than hedge-fund titans such as George Soros or Julian Robertson did at the height of their powers, but his sheer trading prowess leaves them in the dust. At the heart of his empire are 40 "portfolios." Each has between one and 15 traders and analysts who execute various strategies. The primary focus is a long-short equity strategy, but more recently the firm has branched out into convertible and statistical arbitrage, quantitative strategies, and big bets on interest rates. Investors' money is channeled through seven different "portfolio companies" or funds—including a core fund, a global diversified fund, and a health-care fund, each with an offshore counterpart. One fund, Sigma, consists mainly of his personal money, say insiders.

But Cohen's reach, and power, extend well beyond the seven funds. The billionaire, who earned an estimated $128 million last year and $428 million in 2001, according to *Institutional Investor*, has a finger in funds other than his own. Top SAC traders have contracts that contain provisions giving Cohen the right to fund up to half their capital if they leave to start their own funds, as many have done. He sometimes gets more favorable terms than other investors, such as being able to pull out his money early. Says a former SAC trader: "Cohen's presence, and market-moving capability, is probably the largest of anyone on the Street."

Cover Story

So is the fear Cohen inspires on Wall Street. Says a trading executive at a brokerage house: "It's great if you're in the Stevie camp that day or that month. But he can turn against you in the blink of an eye and redirect his capital somewhere else if he gets pissed off." Few of the several dozen people—including former and current employees, other hedge-fund traders, Wall Street analysts, and proprietary traders—that *BusinessWeek* interviewed over a three-month period would speak on the record about Cohen or SAC. Cohen, who's "almost as secretive as Howard Hughes," according to one source, declined to be interviewed or photographed. An insider describes him as "incredibly camera-shy and publicity-averse." He requires employees to sign dense confidentiality agreements. SAC officials would not comment on the record for this story.

Colleagues praise Cohen for his intensity and singular focus on reading the tape—identifying trends by studying money flowing in and out of stocks. He teaches his traders a strict discipline of cutting losses by bailing out of losing positions fast. His own ability to acquire and distill bits of seemingly innocuous information and then apply them to his trading is unparalleled. "He has incredible instinct and the uncanny ability, when faced with 100 facts, [of] knowing which one to pay attention to," says Jack D. Schwager, author of *Stock Market Wizards*, a book about world-class traders. Laszlo Birinyi, president of Birinyi Associates Inc., a vestment research firm in Westport, Conn.: "Cohen can a this huge amount of input and come out with music most of us just come out with noise."

Cohen started picking up these skills at an early ag grew up in Great Neck, N.Y., in a strictly middle-class ily, with a father who worked in the dress manufact business and a homemaker mother. As a child, he foll sports scores assiduously in the *New York Post* that his f would bring home every evening. He started noticing tha financial pages were also filled with numbers. "I was nated when I found out that these numbers were price they were changing every day," he told author Schwage his early teens, Cohen was hanging out at a local brok

HARDBALL HEDGE FU

TAKING THE STREET

Traders call to **BUY LARGE AMOUNTS** of a certain s from several banks and brokers within a very s period. The aim: Clean them out of inventory, that the firms they hit are market makers who have to buy the shares back on the open mark replenish their holdings. That drives the price stock up. **AFTER THE STOCK POPS**, traders often sel —sometimes back to the very desks they boug

e, watching stock quotes. "You could see volume coming a stock and get the sense that it was going higher," he Schwager. These days the action in the stock market is ist that it's difficult to follow the tape so closely, "but ything I do today has its roots in those early tape-read- xperiences," Cohen told Schwager.

y the time he attended the University of Pennsylvania's rton School, where he earned a bachelor's in economics, en was so obsessed with stocks that he traded between es, according to a college friend. He was also a mean pok- ayer at Wharton. "I thought that I was quite the poker er, but Steve cleaned house on me," says a longtime d and SAC investor. After Wharton, Cohen headed to Wall t, where he landed a job as a junior trader in the options rage department at Gruntal & Co. in 1978. His very day, he made an $8,000 profit, and eventually was netting nd $100,000 a day for the firm, says his former boss e, Ronald Aizer. "He learned early on how to use the -trading ability of the big firms" by watching their es, says Aizer. By 1984, Cohen was running his own ng group at Gruntal, which he did until he set up SAC. riends say Cohen, though now immensely wealthy, has r been driven entirely by money. "He loves what he does. The money is merely his scoreboard," says one longtime friend. His stats are impressive. Armed with hot information and an ironclad trading discipline, Cohen has posted blowout returns throughout his firm's 12-year history. He has been up an average of at least 40% annually before his eye-popping 50% performance fee. (Most hedge funds charge 20%.) Last year, his worst ever, Cohen gained 13%, according to investors. "It was quite a disappointing year for him," says George Fox, an SAC investor and president of Titan Advisors Inc., a fund that invests in other hedge funds. Still, with the Standard & Poor's 500-stock index down 23%, it was almost like turning water into vintage Bordeaux. In the first half of this year, SAC is up 14% before fees, vs 11% for the S&P 500. Says Fox: "Steve trades very actively. That's one way he controls risk. He won't let a losing position sit there." Cohen and his business partners are the biggest investors in the fund, comprising some 60% of its assets. The remaining investors are typically other big-money, largely anonymous Wall Streeters. In the past three years, Cohen has returned most of the pension money that his funds managed, says a former trader.

Cohen's single-minded focus puts enormous pressure on SAC's 200 or so traders and analysts. "If you can't cut it

SAC traders recall three aggressive tactics that gave the hedge fund an edge, but trategies aren't exclusive to SAC. Sources familiar with the firm say it doesn't use them

THE REVERSE DESK

out who's trading what stocks travels fast. vals see a fund buying or selling, they to jump on the bandwagon, moving the price the fund. So some funds operate a "reverse at **NOISILY MAKES SMALL TRADES** in the opposite in an effort to wrong-foot the free riders and rable prices.

HOUNDING ANALYSTS AND COMPANIES

Some hedge funds make frequent calls to a stock analyst to discuss upgrading or downgrading a stock. "They don't exactly say, **'CHANGE YOUR RATING OR ELSE,'** but they give you a hypercharged sales pitch on why you should change it," says one analyst. Others badger executives for information if they see a company stock moving for no apparent reason.

COHEN GOT HOOKED WATCHING STOCK TRADES IN HIS TEENS. "EVERYTHING I DO TODAY HAS ITS ROOTS IN THOSE EARLY . . . EXPERIENCES," HE TOLD AN AUTHOR

within a few months of starting, Stevie will blow you out like that," says a former trader, who says he was fired for losing a substantial amount in one trade. Another says he left to escape the "ulcers and night sweats" he suffered while working there. SAC traders, who often earn $2 million-plus, are paid according to what they make on their individual trades, not on the overall performance of the fund, as at most hedge funds. "You eat what you kill," says one former trader. Adds another: "At SAC, you either perform or you're dead."

Earlier this year, the Securities & Exchange Commission launched a wide-ranging investigation into the $500 billion hedge-fund industry, including whether some of its practices represent conflicts of interest. "Few hedge managers are out-and-out fraudsters, but there are no doubt thousands who have convinced themselves that crossing some lines is O.K.," says Randy Shain, president of BackTrack Reports Inc., a business investigator. *BusinessWeek* didn't turn up any records of disciplinary action against Cohen or SAC by regulators at the SEC or the National Association of Securities Dealers.

Some of Cohen's investors see the criticism as sour grapes. "People on Wall Street tend to get jealous of anyone with a terrific track record," says one. Adds Columbia University securities law professor John C. Coffee Jr.: "If you are a market force that's very successful, you're going to have some vocal enemies."

Because he practices what a former SAC trader calls "active trading on steroids," there's little doubt that Cohen and his traders are very aggressive in seeking an edge. On Dec. 27, 2001, the day after ImClone Systems Chief Executive Samuel D. Waksal found out that the Food & Drug Administration had rejected an approval application for the company's cancer drug, Erbitux, an SAC trader named Jason Bonadio was one of a handful of investors to call Waksal that day. Former traders say SAC noticed a price movement, though the news wouldn't be publicly released until the next day. Domestic diva Martha Stewart placed her now infamous call to Waksal 17 minutes after SAC's, according to Waksal's phone log obtained by a congressional committee investigating ImClone. Sources familiar with the firm say Bonadio's call was forwarded to ImClone's investor relations department and never returned. SAC lost "millions" on a long tion on ImClone, they say. Bonadio, who has left SAC, d to comment.

Recently, the whispers about how Cohen and SAC o evolved into full-fledged buzz. In January, one of SAC traders, Michael Zimmerman, came under SEC scrutiny legedly trading on information in company reports writt his wife, Holly B. Becker, a noted Lehman Brothers In analyst, before they were published. Both Becker and merman were served in late January with Wells Notices uments warning of a possible civil action by the SEC re to stock trading. Their lawyers declined comment. Sour miliar with the company say not under investigation by th They add that if anything unt occurred, it took place before merman joined SAC. Because merman still works at the firm affair has brought a great d unwelcome publicity to the fun Cohen himself.

BusinessWeek has learned situation that has the appearan a conflict of interest. Glenn Tat a trader at Sigma, one of C funds, had been actively tradi stock of retailer American Outfitters Inc. in 2001 and 20 was then living at the same a as Kindra Devaney, a retail an at Fulcrum Global Partners, w now his wife. At the time she negative on American Eagl Jan. 28, 2002, she issued the "sell" rating among the 21 ana then covering the company, ac ing to Bloomberg Financial Ser *BusinessWeek* found no evi that she ever shared inform with Tatarsky about American gle before publishing her repo that he traded on anything he from her. However, he did buy on each of the three days le up to Devaney's sell recomm tion, sources familiar with the ter say. Either way, the inc raises questions about how SAC dles potential conflicts of int when employees trade stocks their partners analyze at firms. Sources familiar with the pany say it has one of the stringent codes of conduct in t dustry. Fulcrum's CEO Micha Petrycki says: "We were una of the situation, but our policy hibits only immediate family trading stocks we cover."

Physically, Cohen doesn't li to his image as the Ramb

SNAPSHOT OF A PORTFOLIO IN MOTION

Cohen's biggest fund, with $1.8 billion in assets, trades furiously, turning over its portfolio 2.6 times a year. On Mar. 30, 2003, it held 418 stocks.

THE 10 BIGGEST POSITIONS

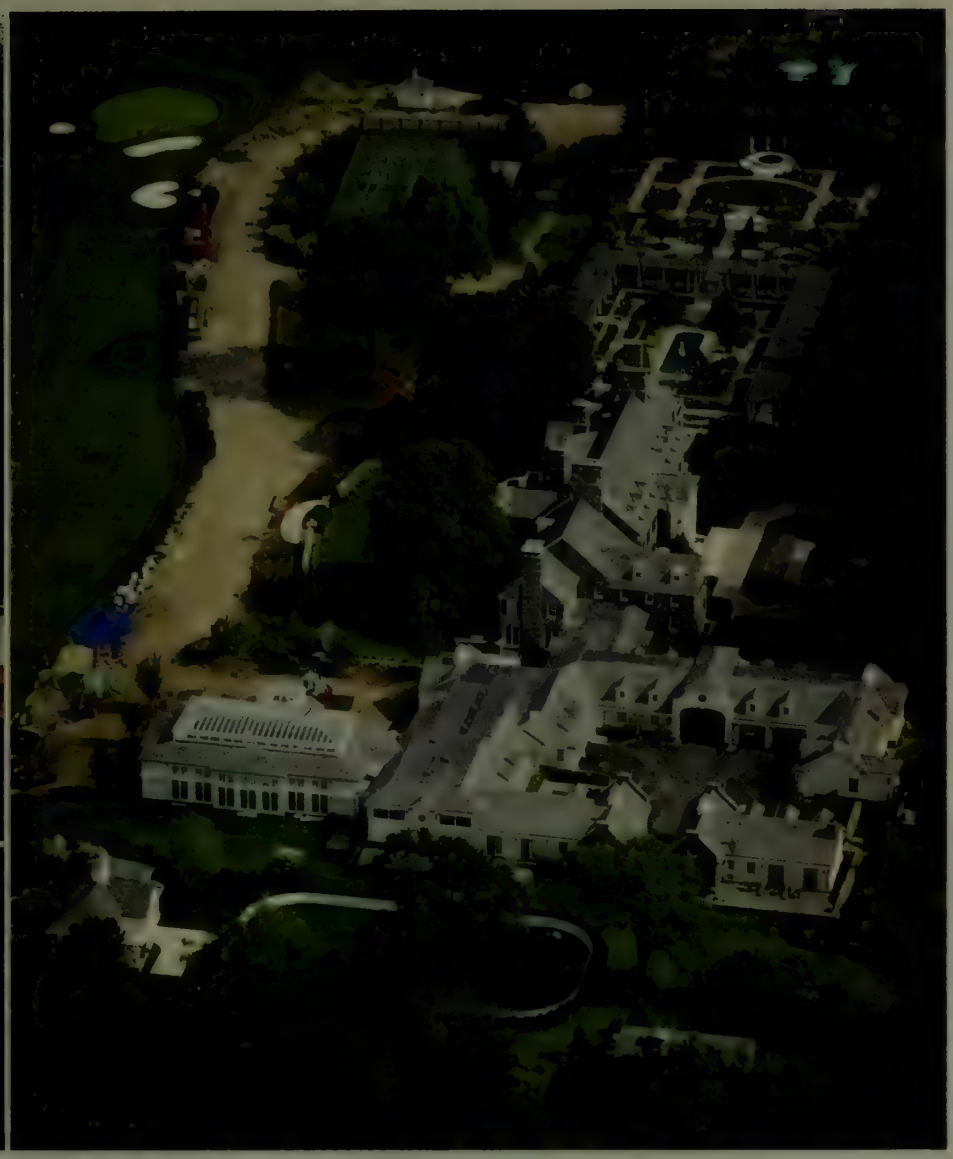
COMPANY	SHARE OF PORTFOLIO
TENET HEALTHCARE	4.3%
JOHNSON & JOHNSON	2.8
MANDALAY RESORT	2.5
HOME DEPOT	2.2
PFIZER	2.1
SPDRs	1.9
MERCK	1.8
CLEAR CHANNEL COMMUNICATIONS	1.8
KING PHARMACEUTICALS	1.7
McKESSON	1.7

THE FEEL OF THE PORTFOLIO

As measured against the Standard & Poor's 500-stock index, the stocks held by SAC had some marked characteristics:

	VS. S&P
LOWER PRICE-EARNINGS RATIOS	86%
HIGHER PAST EARNINGS' GROWTH	136
HIGHER EXPECTED EARNINGS' GROWTH	120
LOWER DEBT-TO-EQUITY RATIO	76
LOWER PRICE-BOOK RATIO	65

Data: Thomson Financial



CLAVES SAC has new head
ffices in Stamford, Conn.
nearby Greenwich,
eighbors call the Cohens'
alled compound Chelsea
ers—after the huge sports
mplex in Manhattan

ers. The bespectacled, balding billionaire, about 5 ft. 8 in., s like a slightly more hip version of George Costanza—the *feld* character played by actor Jason Alexander. "He's key and self-deprecating—he definitely has an awkward- about him," says Schwager. Even when Cohen is exe- g a multimillion-dollar trade, adds Schwager, he exhibits zenlike calm, it's "like he's ordering a sandwich." Says Kiev, a psychiatrist and trading coach who has worked Cohen and his traders for more than 10 years: "As the ket evolves, Steve keeps recreating himself and never s on his laurels. He always asks himself, 'what more can , what did I do wrong, how can I do better?'"

alm and self-reflective he may appear, but Cohen is not se to using sharp elbows to get to the head of the line. instance, several industry insiders say SAC sometimes s to suss out what other hedge funds plan to do and them to the punch.

o stop rivals from riding its coattails, SAC sometimes es head-fake trades to camouflage its own intentions, former SAC traders. It's a tactic, they say, Cohen learned after setting up SAC in 1992 with $20 million of his and investors' money. Says a former assistant to Cohen: the beginning, things were so disorganized that a trader ld be selling off shares of a stock just when Stevie want- o buy. Stevie would stand up and yell at the trader." But en also noticed the stock would drop like a rock if the oth- AC trader sold first. Then, Cohen could buy back the k, then some more, at a cheaper price. Critics claim that en operates what they call a "reverse desk." Former ers say it works like this: The firm purchases a relatively small amount of the stock, then starts selling it off through various Wall Street brokers. "When word gets out that SAC is selling, the Street goes nuts and also starts unloading big blocks," says one. Then Cohen swoops to buy. Sources familiar with SAC say that this type of trading or a reverse desk have never existed. Even if it does, it wouldn't pose any legal problems. Says Columbia's Coffee: "There's nothing wrong with making inconsistent orders in order to prevent your competitors from knowing what you're doing."

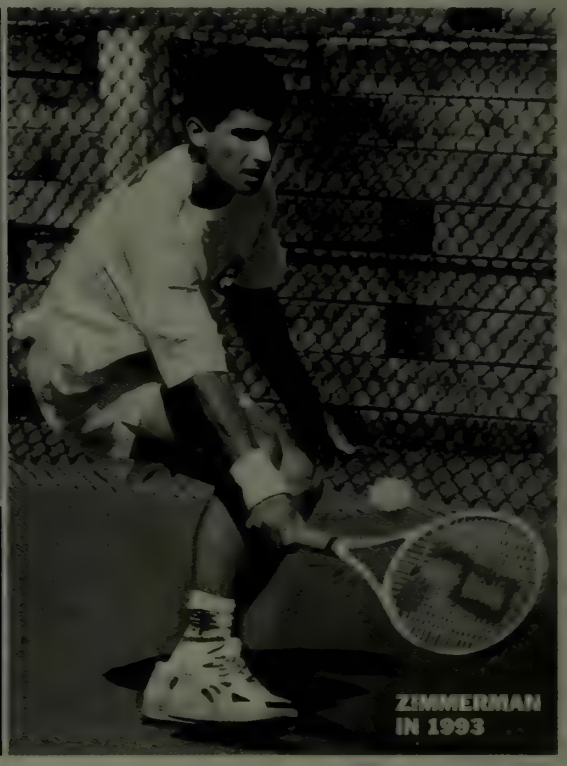
In another tactic, Cohen and his core group of traders sometimes "take the Street," according to former traders. SAC buys large blocks of a particular stock through a handful of major brokers simultaneously in an attempt to clean out their inventories. Often, the big investment banks have to buy back shares on the open market to replenish the inventories they need to hold as market makers, thus causing a pop in the price. Says a former SAC trader, "Stevie can take 8 desks in 10 minutes. The more guys he has doing what he's doing, the more he can move stocks." Once the stock has risen, SAC might even sell the same shares back to the brokers, making a tidy profit. Sources familiar with SAC say the firm doesn't engage in the practice. Says Coffee: "There's nothing wrong with trying to clean out market makers to get a lot of stock quickly at a reasonable price. If a large hedge fund buys slowly, the word gets out and that drives the price up more."

SAC also sometimes orchestrates "short squeezes," say former traders and rival fund managers. When there's a large

IN THE WAKE OF STREET SCANDALS, SAC IS AIMING T LIVE DOWN ITS BARRACUDA-LIKE IMAGE. "THEY'RE TRYING TO CLEAN UP THEIR ACT," SAYS AN EX-TRADE

short position in a stock, SAC will start buying it, causing shorts to cover, thus driving up the price—at which point SAC sells. Sources familiar with the firm say SAC has never done this. Experts say the practice is legal.

What makes Stevie mad? Simple: Not getting preferential treatment. Several analysts say that SAC traders often pressure them for upgrades, downgrades, information, or insight into trading flow. And sometimes getting the information first doesn't seem to be enough. Says one analyst: "There was one day when I had at least 15 voicemail messages from two different SAC traders about how I was rating a particular stock. They don't exactly say, 'change your rating or else,' but they give you a hypercharged sales pitch on why you should change it." Sources familiar with SAC say that the firm expects employees to conduct themselves in a professional manner and doesn't condone such behavior.



CONFLICT? Internet analyst Becker and her husband, SAC's Zimmerman, could face civil action by the SEC

Of course, Cohen usually makes nice with the Street. For example, former traders and rivals say one way he built his business and his relationships with brokers was by buying secondary offerings—when public companies decide to bring more shares to market—on which brokers receive around 40¢ to $2 a share on a built-in sales commission. "If you take down a million shares of a secondary, you've just paid your broker $1.5 million," says a fund manager. "That's how Stevie started off paying the Street."

Cohen's home life seems a far cry from the frenzied pace of SAC. He met his wife, Alexandra, who grew up in the Bronx and is described by a friend as "dark-haired and pretty in a petite way," through a dating service after divorcing his first wife. "From the time she was a child, Alex always said she wanted to marry a millionaire. She struck out," jokes a family friend. "She got a billionaire." Cohen has seven children and stepchildren.

In 1998, the Cohen family bought a 30-room Greenwich mansion built in 1930 for around $15 million. It was quite a move up from their previous $2 million house. They put millions of dollars more into an elaborate renovation and extension, say friends. Says one: "Steve told me, 'We took a beautiful old house and basically ruined it.'" It is completely obscured from the street by a roughly 12-foot-high wall. Cohen is so secretive that he installed an extensive alarm system that beeps whenever someone walks into a room or out, say acquaint

The grounds, which some neighbors call Chelsea Pier ter the mammoth Manhattan sports complex on the H River—include a basketball court that becomes an ice-sk rink in winter, several golf holes, and a bubble-enc swimming pool. "For kids, getting invited to the Coh one of the most coveted invitations in Greenwich," s neighbor. Still, neighbors complained about massive, le renovations at the house.

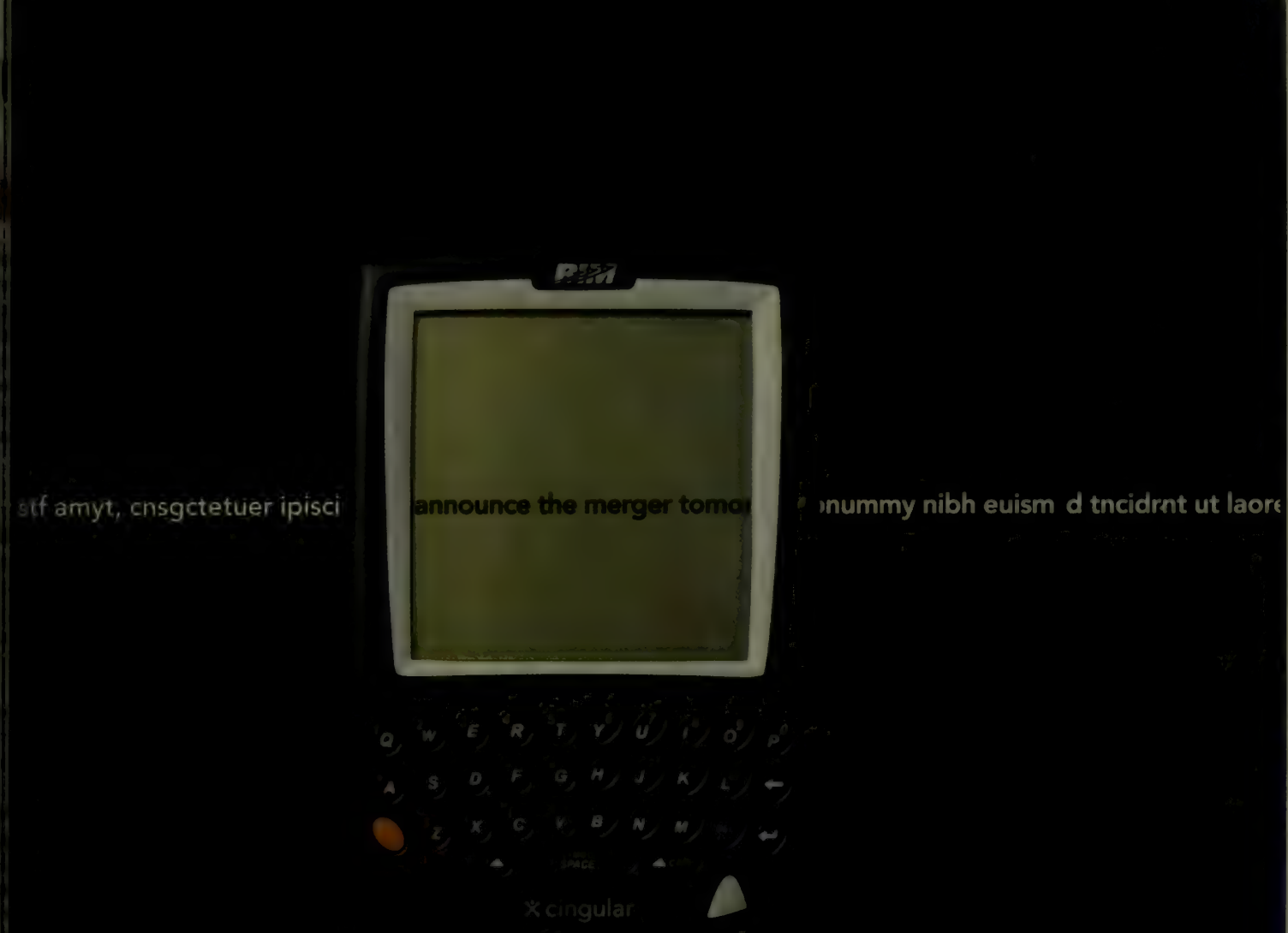
Cohen may not be impressed by his own billions, but has coaxed him into "lavish entertaining, round-the- art-buying trips, white-gloved butlers, that sort of t says an old acc tance. For a h warming party sent out an invi she thought of self: a deck of ing cards with a tograph of Ste the king in a v robe and crown, self as the queer children, and va and sundry hous help as other ca

Still, friends Alex is a dr force behind the hen's generous c table giving. In they gave $15 m to the Robin H Foundation, a c ty founded by he fund icons Paul dor Jones II Stanley Druc miller. And the given millions to aid families of World Trade Center vic and funded a walk-in clinic at Greenwich Hospital, among er activities. Cohen is also on the board of the Michael J. Foundation, a nonprofit that fights Parkinson's disease.

The flow of charitable donations isn't likely to dry up time soon. SAC is having yet another good year, by standards. But those 14% gains may not be setting well Cohen. No doubt he wants to return to his mammoth plus gains. That may explain, in part, why he has bran out into multiple strategies recently. Indeed, in the wak Wall Street scandals and the increased scrutiny of anal SAC is trying to live down its barracuda-like image. It rec hired a public-relations firm to assist it. "They know spotlight is on them and they're really trying to clean up act," says a former Sigma trader.

Cohen's active trading is now mainly focused on the f core fund that he manages. He continues to prune back amount of capital he trades—making the fund a lot r nimble—while at the same time expanding his palett trading strategies. Says a rival hedge-fund manager: seems to be trying everything to get that old magic ba Not that Stevie ever really lost it.

Cover Story



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BusinessWeek

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MAY 21, 2003

MAKING LIFE RICHER

Cheers!

America's Growing Thirst for Red Wine

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dividends

tips, tidbits & more

EDITED BY TODDI GUTNER

THE STAT

1.2

ENT of all U.S. home gages were in the ss of foreclosure in the uarter of 2003. That's a d high.

Data: Mortgage Bankers Assn.

MEDIA

WS FROM L OVER

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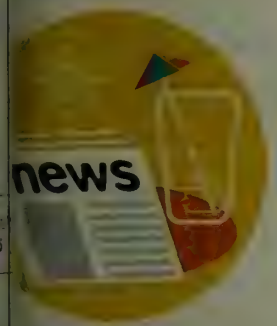

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REAL ESTATE

Going Down?

PEN A BOOK CALLED **The Coming Crash in the Housing Market** (McGraw-Hill, $14.95), and you might be accused of craning your neck for signs of impending doom. Just the same, author John Talbott has spotted something worth noting: **In the past six months, house prices stopped rising.** And in such key markets as Chicago, Philadelphia, and San Francisco, they sank. "Many cities may have peaked," says Talbott, a onetime Goldman Sachs banker and now a visiting scholar at the Anderson School of Management of the University of California at Los Angeles.

Talbott's view contrasts with the prevailing sentiment, which is based on the latest real estate industry statistics as traditionally reported—that is, by comparing the median price of existing single-family houses to the median 12 months earlier. By that measure, the national median price rose 7% in the 12 months ended Mar. 31. Using the same industry statistics, Talbott looked at the six months ended Mar. 31. **Turns out the national median price ran flat.** Naturally, even if overall growth is stalling, hot spots remain. Among them: Las Vegas, Sacramento, and Sarasota. *Robert Barker*

GIZMOS

COUNTING WATTS

Hook up this kilowatt-hour meter to that old fridge in your garage. You may retire it when you learn how much juice it uses. **Kill A Watt, $40 from Repair-Clinic.com,** plugs into a wall outlet and logs the power consumption of anything that's plugged into it. It teaches you to turn off your computer when you're done (save $100 a year) and whether to repair or replace older appliances when they break.

MUTUAL FUNDS

THE GOOD FIGHT

Want to shake up Corporate America? **H Team Capital,** a New York startup, has an offer for you. In September, it will launch a **fund that will wage proxy contests and other legal battles against companies with shareholder-unfriendly policies.** The strategy has paid off for big investors such as pension giant TIAA-CREF and investment manager Relational Investors. But because proxy battles are costly and fail half the time, don't be surprised to pay high expenses and see wide swings in returns. H Team has yet to file its fees.

The Rise Of the Reds

As U.S. wine sales grow, reds hav overtaken whites. BY AMY CORTE

BUD GEBHARDT is se red. Wine, that is. The owner of Park & Orch Restaurant in East Rut ford, N.J., has watched s of red wine surge in the p few years. A dozen years ago, white wines counted for three out of every five bottle sold. "Now, we sell 80% red wine," he s That's especially notable consider

TASTINGS: A Few Good Bets That Won't Break The Bank

Eden Valley
Syrah
$15
Marked by a deep rich color and distinct berry and pepper flavors

David Bruce
Central Coast Pinot
$20
Medium weight, with supple, fruity, and slightly earthy tones

ark & Orchard serves mostly seafood and vegetarian —food that traditionally has been paired with white

hardt's experience reflects a broader trend: Americans rinking more wine overall, and increasingly, they are ing reds. In 2002, Americans consumed 210 million of wine, up from 135 million in 1991. During that pe- red wine went from 16% of the market to 43%, while declined from 50% to 39.6% (with blush wine ac- ing for the balance), according to a soon-to-be-released tudy by M. Shanken Communications, publisher of *The Spectator*. For California wines, which up two of every three bottles consumed U.S., reds edged out whites in 2002 for rst time in the five years that market rcher MKF has been tracking California sales.

perts say the rise of reds may have to do eports that consuming moderate amounts wine can lower the risk of heart disease, ll as the public's growing familiarity with Many drinkers start off with sweet white , such as chablis or white zinfandel, move semi-dry whites, such as chardonnay or gnon blanc, then leap to a light, fruity noir or a smooth, rich merlot.

FLAVOR, SOFTER TANNINS

l is a natural as people start drinking wine with meals. Its complexity can en- flavors—even of foods not typically as- ed with red wine. For example, pepper- ncrusted tuna might be better emented by a spicy red, such as a syrah, a buttery chardonnay.

ou are new to red wine or just looking ersify from your usual merlot, there has been a better selection of easy-drinking reds. "Wines efinitely softer and more approachable these days," Paul Birman, buyer for wine retailer PlumpJack in San isco. Advances in fermentation technology make it le to produce wines with more flavor and softer tan- -the substance that gives red wines their pucker. improvements also let you drink the wine when it's at h younger age. "You can open a 2000 cabernet sauvi- and enjoy it that night," says Birman. "In the 1970s, ould have stored it for 20 years."

winemakers around the world adopt the new tech- , an international style is emerging modeled on the Cal- style that often blends grapes from different vineyards gions. That makes it easier to experiment—and save.

California and France still produce tellar wines, but some of the best values come from Australia, New Zealand, Spain, and southern Italy. "Rather than spending on big brand names, such as Mondavi and Beringer, where prices have escalated," advises Steve Gett, wine director at Union Square Wines & Spirits in New York, opt for offerings from lesser-known regions.

A good variety to try is syrah (called shiraz by Australian winemakers). Its rich fruit, spice, and velvety feel make it a great all-purpose wine. U.S. sales of California syrahs last year rose a heady 922%, albeit from a small base, says MKF. Imports from Australia are also flying off store shelves. "It's the new merlot," says Birman.

Pinot noir is another versatile light red. Birman suggests enjoying it slightly chilled on a hot day. Pinots make a nice accompaniment to grilled fish, chicken, and veal. A Côte du Rhône from southern France would do as well.

A newcomer on the scene, at least to American palates, is tempranillo, the hearty Spanish grape that goes into Riojas. Spanish winemakers are turning out tempranillos blended with other varietals and made with hints of oak and vanilla that can stand up to California's finest merlots. From there, you can move up to some of the bigger, more complex reds, such as cabernet or zinfandel. But take your time. The fun is in getting there. ■

A GUIDE TO RED WINE GRAPES

- **CABERNET SAUVIGNON** The grape responsible for some of the best wines to come out of California and France's Bordeaux region. Full-bodied and tannic, typically tasting of dark berries and even tobacco.
- **MERLOT** A cousin of the cabernet sauvignon grape but less tannic, it makes soft, velvety wines with ripe berry flavors that can be drunk at a young age—say, two or three years.
- **PINOT NOIR** A versatile, lighter red that goes well with fish as well as meat. Often difficult to cultivate, so good pinots can be pricey.
- **SANGIOVESE** The Italian chianti grape is being produced, with great results, in other regions as well. Its high acid content makes it a good partner for acidic foods, such as almost anything in a tomato sauce.
- **SYRAH/SHIRAZ** Called syrah in France and the U.S. and shiraz in Australia, this grape produces wines that can vary from fruity to spicy. These wines typically deliver great value.
- **TEMPRANILLO** The mainstay of Rioja, Spain's best-known wine-making region. It produces soft, flavorful reds and is often blended.
- **ZINFANDEL** The grape behind bold, intense California zinfandels.

Vega Sindoa
Tempranillo/Merlot
Under $10
A very drinkable blend that's bursting with ripe berry flavor

Rosemount
Shiraz
Under $15
Dependable. Good value from one of Australia's best-known shiraz producers

Di Majo Norante's
Sangiovese
Under $10
From Molise, an up-and-coming wine region in Italy. Try instead of traditional Chianti

Ooh-la-la Prices

French wine is getting cheaper, thanks to stiff competition. BY JOHN ROSSANT

FACED WITH OVERSEAS competition and abundant inventories, Beaujolais winemakers are ripping vines out of the ground rather than produce wine that must be sold below cost. In Bordeaux, producers are almost giving it away: At the city's recent Vinexpo wine fair, the world wine industry's most important get-together, the worried talk was of red Bordeaux being offered at just one euro a bottle.

Bad news for French producers is great news for wine lovers. Winemakers are cutting prices to keep their American customers, so great wines are going for less than they otherwise might, especially in the face of a weak dollar.

Domaine de L'Ameillaud is a case in point. It's a highly regarded Côtes du Rhones Villages wine from Cairanne, one of the best of the Rhone Valley's 16 "villages," or classified subregions. About 35% of the 300,000 bottles the estate produces each year go to North America. Most good Côtes du Rhones Villages wines retail for $15 to $18 a bottle, but owner Nick Thompson has maintained L'Ameillaud at around $12.

BON MARC
Good
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dollar

Other French regions have great values, too. Good Beaujolais is selling at rock-bottom prices. A bottle of Georges Duboeuf Beaujolais Villages can now be found for as little as $8 a bottle. Burgundy and Bordeaux, whose wines traditionally a hefty premiums, are looking more reasonable. Tollot Be one of Burgundy's most accomplished winemakers, b Chorey-lès-Beaune 2000 will set you back less than $ Bordeaux, a string of abundant years means that vir such as 1999 are relatively cheap. Château Cantemerle from Margaux and Château Carbonnieux 1999 from G are well priced at $17 a bottle and ready to drink.

"When it comes to great-quality wines, it's now a sho paradise," says Sam Perkins, executive editor of *The Enthusiast*. That's reason to uncork a bottle.

HEALTH

NUTRITION

What Popeye Should Be Pushing: Protein

Popeye was wrong: You won't be strong to the finish if you eat your spinach. **You've got to eat protein to build and maintain muscle mass.**

It also makes a difference what kind of protein and what time you eat it. Metabolism researchers at the University of Texas Medical Branch (UTMB) in Galveston are working with NASA and the National Institute of Aging to figure out how to prevent the muscle loss that naturally occurs as people age or travel in space. Their findings suggest you should eat protein an hour or so before you exercise to kee and increase muscle mass.

The reasoning? Your body is more likely to conve protein to muscle if it's circulating in your system be rather than after physical activity. "Exercise seems help you grab more of the amino acids out of the blood," says Douglas Paddon-Jones, an assistant professor at UTMB, referring to the molecules that the building blocks of protein.

Don't eat more than 3 oz. of protein a time: Your body can utilize only so muc The rest is excreted as waste or, worse, stored as fat. The best kind of protein contains the amino acid luceine. Food sources include meat, beans, nuts, an brown rice. "Luceine appears to furthe stimulate uptake for muscle creation," Paddon-Jones. And there's only a trac it in spinach. *Kate Murphy*

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Stocks: Take The Breadth Test

Charting how many issues are involved in market moves can help you flag trends (P.S. This rally looks strong). BY SUSAN SCHERREIK

IS THE four-month rally in stocks for real or simply a tease? One way to find out is to compare the number of winning stocks to losers each day. Wall Street pros call this market measure "breadth." With breadth, you look not just at how high the market climbs but how many stocks are participating in the move. Right now, breadth is telling us that the rally has legs.

Here's why: A rally will have more staying power if it draws in more and more stocks as it goes up. This shows that investors are becoming increasingly confident in the stock market's outlook and are snapping up shares of large and smaller companies in a broad swath of industries. Conversely, if the market averages are climbing but more and more stocks are falling, the rally is losing steam. "Breadth is like the thrust in a rocket ship," says Richard McCabe, chief market analyst at Merrill Lynch. "The more power behind a stock market move, the more likely it is to last."

In this installment of Market Measures, a series on analytical tools that can help you buff your investing s we'll show you several ways to me breadth. The most common: Keep a ning tally of net daily advances o New York Stock Exchange. To c late this figure, subtract declinin sues from advancing issues and ig those that remained unchanged. Big Board posts data on advancing declining issues daily on its Web nyse.com. Click on Press Room, statistics, then Hourly Statistics.

It works like this: On June 25, issues rose and 1,492 issues fell o Big Board, so net advances were

this is the first day we are track-readth, we add 279 to a base num-let's say 10,000. (Starting with a base number ensures that you'll positive numbers during periods losing stocks dominate and the advance is negative.) That brings otal to 10,279. On June 26, net ad-es were 987. We add that figure to previous total, bringing the cumu-net advances on June 26 to 11,266. recently, on July 7, net advances 1,174.

II THE TREND

's key is not the absolute numbers he trend. Many stock analysts plot aily net advances of the stock mar-h a graph that can span months or years. This graphic representation mulative breadth is called the ad-decline line.

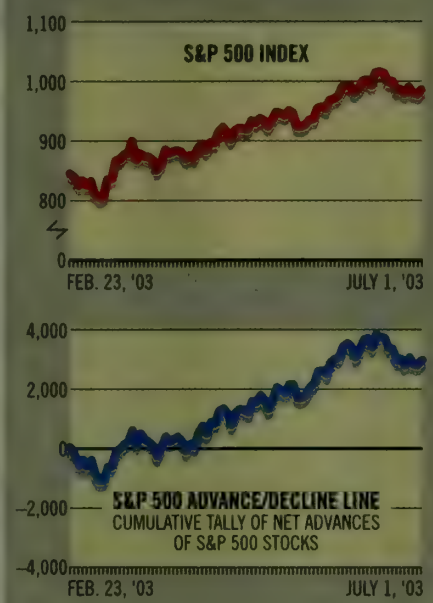
an investor, you want to see the nce-decline line making new highs key stock indexes such as the dard & Poor's 500-stock index, AQ Composite Index, and Dow industrial average are doing like-(chart). That has been the pattern mid-March, when the stock market a powerful rally that has lifted &P 500 25% and the NASDAQ Com-35%. "One of the most convincing cteristics of the market's recovery been the extremely positive lth," says Merrill's McCabe.

pically, the advance-decline line be-to turn down months before the et does. That was the case in 1987, the advance-decline line peaked arch, seven months before Black ay on Oct. 19. During extremely running bull markets, the advance-e line can peak a year or two be-stock indexes do. That happened the 1929 stock market crash, and recently, the 1990s bull market. lth on the S&P 500 peaked in Janu-999, and quickly slid downhill; the 00 peaked in March, 2000 (chart).

other way to track breadth is to ate the ratio of advancing issues se in decline. At the start of pow-rallies, there are often short periods the number of advancing issues ahead of losers by a wide mar-3 to 1 or even 4 to 1. Tracking this can alert you to these investor buy-renzies. For instance, during the week in June, when the stock in-rose 2% to 3%, advancing issues ed declines by 3.2 to 1 on the NYSE y nearly 2 to 1 on the NASDAQ, McCabe. On more typical days, ad-g equities outpace declining issues

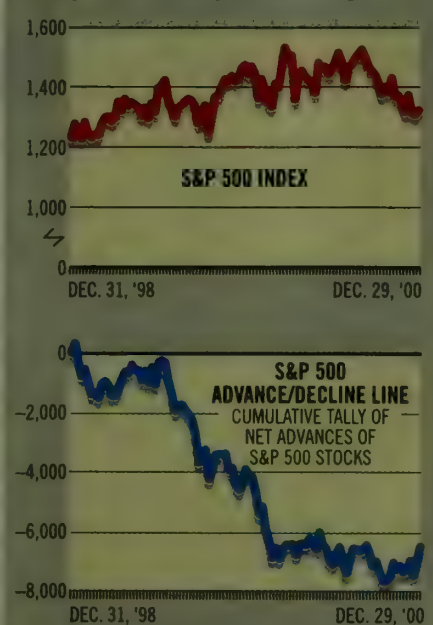
Improving Breadth Confirms Stocks' Rally

Since March, the number of stocks advancing has continued to outpace the number declining. The graphic representation of this measurement is the advance-decline line. Here, it's tracking the S&P 500. Currently, the trend is positive for stocks.



Market Averages Climb—But Breadth Doesn't

Near the end of the last bull market, the S&P 500 continued to climb, but breadth peaked more than a year earlier. Such a divergence—higher stock prices with falling breadth—is a sign that a rally is faltering.



Data: DecisionPoint.com

by a 3-to-2 margin during rallies, he says.

In addition to looking at the breadth of the NYSE, you can also examine the breadth of the S&P 500, NASDAQ Composite, or the Dow industrials. It's a good idea to scan more than one breadth indicator. Paul Desmond, president of Lowry's Reports, an investment research firm, filters the NYSE data to be sure he gets only common stocks of U.S. companies. The Big Board has plenty of preferred stock, foreign stocks, and closed-end bond funds that could skew the figures. Lowry's data are available via a weekly e-mail newsletter ($300 annually; 800 345-0186 or lowrys-reports.com.)

This is the fifth in a series showing how various **Market Measures** can help you identify opportunities and avoid traps

Another excellent source of various breadth statistics is DecisionPoint.com, which costs $20 monthly. Also useful on the site is a related breadth measurement of the number of stocks that make new 52-week highs and lows. By that account, Carl Swenlin, president of DecisionPoint.com, says the recent stock market rally looks strong because when stocks have declined, fewer and fewer have made new 52-week lows over the past few months.

MORE NEW HIGHS

Additionally, a growing number of stocks are surging to new 52-week highs. During previous bear market rallies, the number of NYSE issues hitting new 52-week highs rarely topped 700, says McCabe. More recently, 1,097 NYSE issues climbed to new 52-week highs.

What if you see breadth start to weaken in the weeks ahead? That would be a signal, says John Roque, a technical strategist at Natexis Bleichroeder, a New York brokerage, not to exit the stock market but to change your strategy to focus your bets on a smaller group of stocks that have the best prospects. Because breadth has been so strong since mid-March, it would take several months after it peaked for the overall indexes to fall sharply, he says.

Most important, remember that even breadth indicators aren't infallible. They're just tools in your investment arsenal that are designed to alert you to new opportunities as well as potential danger. Used in tandem with other market indicators, they just might help you stay on the winning side of the Street. ■

Acura's Sporty Luxe

Its new TSX can take on Mercedes and BMW. BY LARRY ARMSTRONG

IT'S A NIFTY LITTLE masquerade, the 2004 Acura TSX. The car is Honda's European-model Accord, dressed up with a new front end, grille, and all the luxury amenities of the company's upscale Acura line. The TSX is Honda's attempt to grab a piece of the ultracompetitive market for entry-luxury sports sedans, a segment whose benchmark is BMW's legendary 3-series.

The new TSX doesn't disappoint. Styling is conservative but smart, especially the rear end. The cabin is properly luxurious. Any quibbles I may have had about this sheep in wolf's clothing—it is an Accord, after all, and there's not even a six-cylinder version—disappeared once I got behind the wheel. If there's a question whether the Acura nameplate is sufficiently prestigious to compete, Acura neatly sidestepped it by pricing the car below other entries.

Far below. The TSX lists for $26,990. While that looks close to the $28,495 base sticker of the BMW 325i, say, or the Mercedes-Benz C230's $28,710, the TSX comes fully loaded. Moonroof. Heated leather seats. Manual or automatic transmission. Big 17-in. wheels. Xenon headlamps. CD changer. Add all of that to either of the extra-cost-option-happy European competitors, and you'll be at least $8,000 poorer.

The only factory option on the TSX is a $2,000 navigation system. I recommend that you s because it also replaces some audi air-conditioning controls with hard use menus on a touch-sensitive s Changing the radio station, for ex would take three steps instead of gle punch of a preset button.

RACY LOOKS: The styling is smart, and the interior cabin is cushy

Otherwise, if you can build prestige into a car in Acura has done it with an elegant instrument pane first-class materials throughout. Wide metal door sill soft-blue ambient lighting welcome you into the ca gauges are big, always lighted, and easy to read. Accen runs along the top of the doors and across the bottom dash, dipping to accommodate the center console: Or with a dark leather interior, it's brushed metal; with l upholstery, it's a wood pattern.

Don't underestimate that four-cylinder, 2.4-liter e It's tweaked to produce 200 horsepower. That's more th four-cylinder Audi A4 and even the six-cylinder BM Mercedes: It gets you to 60 mph in seven seconds. Th ropean Accord is smaller and sportier than the U.S. v to begin with, and Honda has made the TSX even mo The steering is quick and precise, and the tight suspe easily hugs corners and absorbs bumps in the road.

The more I drove it, the more I liked it. A precision neered Japanese car, bred for European tastes, outfitte American luxury. About the only thing it lacks is a Bimm Benz badge on the front. That, and the high price.

TRAVEL

Boston: A Graveyard Smash

As a bright moon hovered overhead, our guide unlocked the heavy iron gates of **Boston's Granary Burying Ground**, established in 1660. He instructed us to walk inside to the obelisk marking the final resting place of Benjamin Franklin's parents. As we approached it, a man dressed in the dark garb of a Colonial gravedigger leaped out from behind the obelisk, shouting and startling everyone. The stranger then used a lantern to lead us around the burial ground, to the graves of **John Hancock, Paul Revere, and the five men killed in the Boston Massacre of 1770**.

Welcome to **"Ghosts & Gravestones,"** a thoroughly entertaining and educational tour of the macabre side of Boston's rich history. Conducted on Thursday to Monday evenings from May through October, the roughly two-hour tour includes walks through two of **America's oldest grave** the Granary and Copp's Hill, in the No End. The rest of the evening is spent r through the streets of Boston in a colo decorated trolley as the guide recount tales of the Boston Strangler and the g said to haunt the Omni Parker House and discusses **Puritan burial practice** among much other local lore. One nic touch: Guests are constantly addresse "mortals," a reminder that we are all o journey that will end in the grave.

The excursion, operated by Old To Trolley Tours, costs $30 per person. Reserve several days in advance by calling 617 269-3626.

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SKELETON MINUTE REPEATER: It chimes like a grandfather clock

When Time Is Money —And Art

Handcrafted watches draw devoted fans with deep pockets. BY KIMBERLY WEISUL

FOR $10, YOU CAN buy a quartz watch that keeps perfect time. But chances are it will never become a collector's item, impress your boss, or give you the eerie feeling that a tiny heart is beating on your wrist. For that, only a mechanical timepiece, powered by a spring instead of batteries, will do. In a mechanical watch, "you can own something that truly could be regarded as a masterpiece," says Chet Borgida, a 58-year-old New York collector and financial executive. "And you don't have to keep it on a wall. You can carry it with you all day long."

The craftsmanship of such watches may be matched only by that of a fine automobile—and the two can cost the Geneva's Vacheron Constantin makes an intricately watch in rose gold (left) that retails for $395,000.

The movement—the mechanism that keeps time—clude hundreds of parts. Just polishing a tapered keep a gear in place can take a watchmaker eight Even with the advent of computer-aided design, m these watches take months to produce, and just a han any model may be made each year. Adding to the some watchmakers have exceptionally long and disting histories. Geneva-based Rolex lays claim to the first tru terproof watch case, the Oyster, first produced in Vacheron Constantin supplied timepieces to Napoleon.

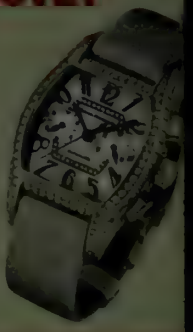
You don't need a royal treasure to buy one of these creations, but it helps. A basic mechanical watch, such as the least expensive Nomos Glashütte, starts at about $700. Officine Panerai's sporty-looking automatics begin at about $3,000, and it's possible to get a Rolex for about the same. After that, prices rise steeply.

In quality, Geneva's Patek Philippe is the acknowledged leader among aficionados. Watch collectors rave that the normally hidden workings behind the face of a Patek Philippe are as painstakingly engraved as those visible through the display back. The cheapest Patek Philippe runs about $9,000.

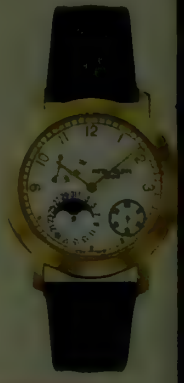
But it's the features known as "complications" that can have the biggest impact on price. A calendar is the simplest. Others include a power reserve, which will keep the watch ticking for a few days even if it's not being worn, a stopwatch, and a moving diagram showing phases of the moon. The minute repeater is the icing on the cake. When the wearer pulls a small lever, tiny chimes ring out the time, similar to a grandfather clock. Minute repeaters can easily cost $100,000.

For all their craftsmanship, "you don't go into watches for the investment opportunity," says Matthew Morse, editor-in-chief of *WatchTime* magazine. Some brands—Patek Philippe, Rolex, Vacheron Constantin—tend to keep more of their value. In general, though, putting money into watches is similar to spending on cars. For collectors, mechanical watches are tiny pieces of art they can wear. And, of course, they do tell the time. ■

WATCHES TO COVET

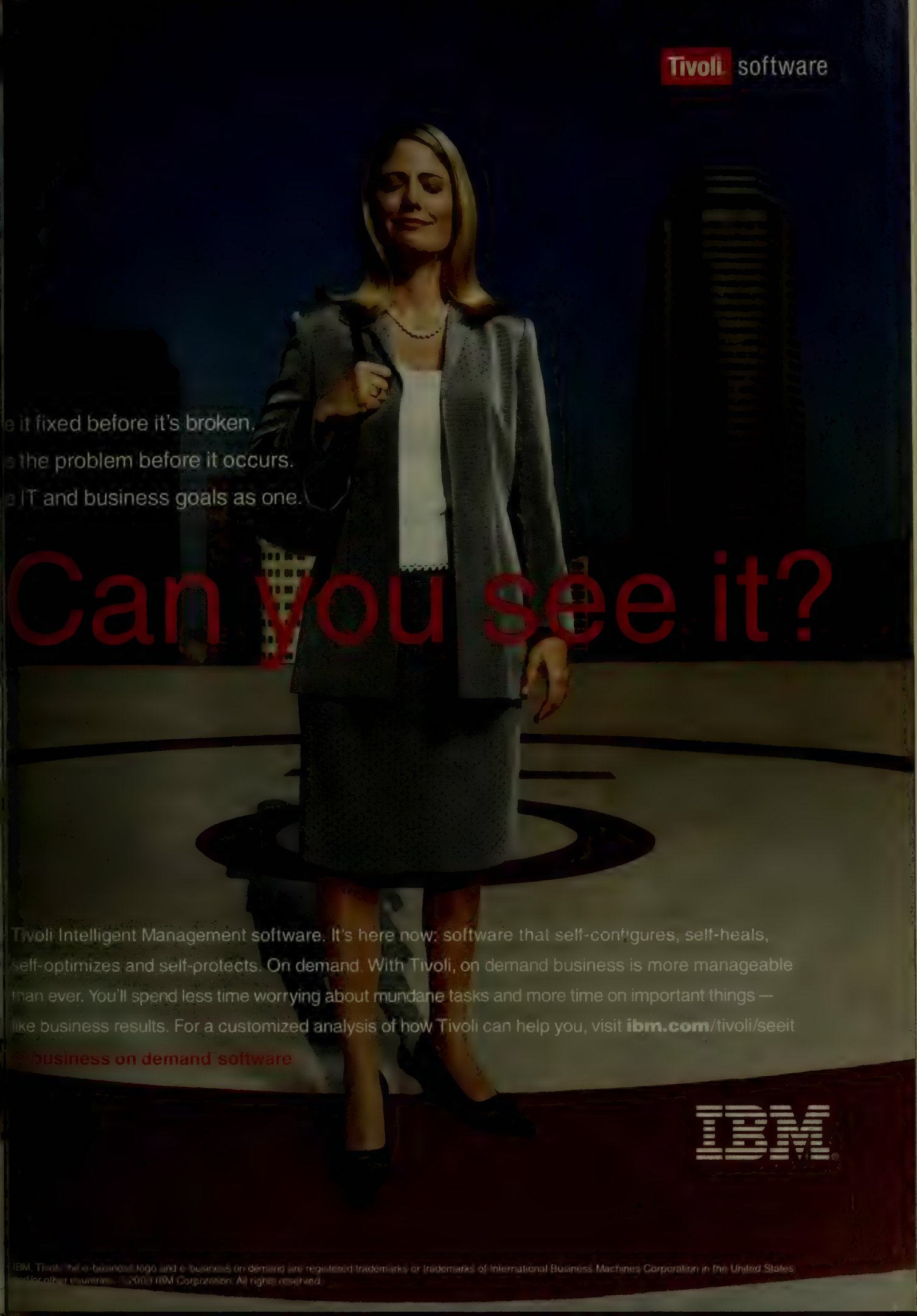


EDWARD PERREAUX
($67,500) Ladies' chro graph with 300 diamo and 36-hour power rese



PATEK PHILIPPE
($20,000) Men's watch with moon phase, date 48-hour power reserve

JAEGER-LECOULTRE
($9,350) Watch with t time zones and date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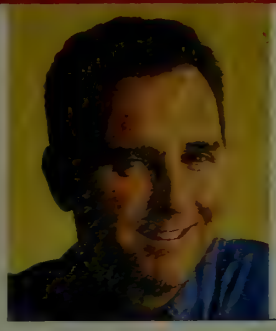


WILL FLORIDA EAST COAST SHAR THE WEALTH?

BY ROBERT BARKER rb@businessweek.c

IN MAY, PRESIDENT BUSH signed into law far friendlier tax treatment of dividends on stocks. In June, the number of companies raising their dividends jumped more than 31% above the average June level over the past decade, according to Standard & Poor's. Some companies couldn't even wait for the ink to dry. Florida East Coast Industries, for instance, announced a 60% boost in its quarterly payout all of 17 minutes after the President put his name on the bill.

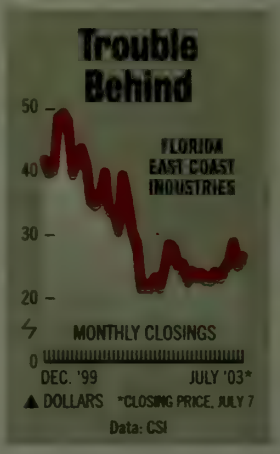
Perfectly understandable cause and effect? Yes. Yet in what could turn out to be another example of the power of bargain dividend tax rates, Florida East Coast may not stop there. Chances are strong that the St. Augustine railroad and real estate company soon will announce a special cash dividend. Such dividends—occasional payments of cash to investors from unusually swollen corporate coffers—are special precisely because they have proved to be so rare. With tax collectors ready to take more than 40¢ of every $1 paid to high-income stockholders, they just didn't add up. Now, with Uncle Sam's top rate on dividends down to 15%, it's a whole new calculus.

As it happens, Florida East Coast turns out to be an excellent example of how this new investment environment might benefit you. It is the 120-year-old descendant of Rockefeller crony Henry Flagler's railroad, which linked Jacksonville to Miami and, for a time, to Key West. Today, FEC still runs a 351-mile freight line, plus a sizable commercial real estate development unit. Obscuring much of this foundation, however, is the wreckage from FEC's disastrous expansion into the Information Age, which lofted and now suppresses its stock price (chart). Late in 2002, FEC dumped EPIK, a fiber-optic telecom-services wholesaler that in the past three years ran up total pretax losses of $447 million.

CLICKING ALONG: FEC's railroad expects profits of $60 million this year

That smarts all the more because the core company has been clicking along nicely. On the strength of such new customers as Tropicana Products, which ships chilled orange juice from a Florida processing plant to distribution centers in Ohio and New J FEC expects profit from railroad operations of about million this year, the same as last year and up from $4 lion in 1999. With an operating margin of better than FEC is second in profitability among North American roads, behind only Canadian National Railway.

Less visible is the cash flowing from FEC's real e unit, Flagler Development. It leases 61 commercial pr ties, the key ones in and around Miami, Orlando, and sonville, from which it expects $41 million to $43 milli cash flow this year. That's up a bit from less than $40 n last year, thanks to improving occupancy rates. All Flagler owns some 6,100 acr Florida but has 3,800 on the m or already under contract t sold. For example, it expec close this year on an $18 m deal for seven acres along the that runs through downtown M Similarly, last year it closed a million deal for an old rail ya Miami that had been listed a FEC's assets as worth just $30



Proceeds from such deals, the nearly $75 million refund collected in April from the Int Revenue Service once it accou for the EPIK losses, mean the pany's treasury is brimming. On July 24, when FEC is s report second-quarter results, it might also unveil its pla all the cash it has accumulated. CEO Robert Anestis me FEC expects $150 million in surplus cash this year a additional $50 million next year. While some or all may mately be used instead to buy back FEC stock, it's a fai that at least a portion also will be paid to shareholders special dividend. "We are committed to [using] it one w the other, or a combination of the two," he said.

It could be any amount, but suppose half were paid o cash. That would be $100 million, or $2.73 a share, distrib over the next 18 months or so. With the stock lately near and a 15% tax on dividends, that wouldn't be half-bad.

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A BIG J&J DEAL COULD BOOST MILLENNIUM PHARMACEUTICA

FROM ITS WEB OFFERINGS, BANKRATE IS TURNING SOLID PROF

DaVITA'S KIDNEY-DIALYSIS CENTERS ARE REALLY CLEANING UP

BY GENE G. MARCIAL

A Rosier Millennium?

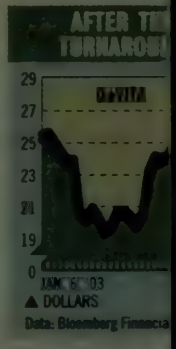
Jump into Millennium Pharmaceuticals (MLNM) stock. That's the word from some Millennium trackers who think its recent fall—from 17.20 in mid-June to 14 on July 1—was unwarranted. It is now at 15. Rumors had swirled that Millennium, which uses genetics, genomics, and screening technology to develop drugs, was takeover bait. So when Johnson & Johnson, a suspected suitor, announced on June 30 that it had agreed to market overseas Velcade—Millennium's approved anticancer drug—the Street felt let down. Some say J&J's terms were disappointing. Other pros disagree: "This is one of the best cancer deals in the history of biotech," argues John McCamant, editor of *The Medical Technology Stock Letter*, and "chances of J&J buying Millennium are enhanced." By retaining 100% of the U.S. rights, Millennium raised the ante, he says. The U.S. is 65% of the drug's worldwide market, and if Velcade is approved for other uses, for which Millennium is holding clinical trials, the company gets more attractive, says McCamant, who owns shares and sees the stock hitting 30 in a year. Millennium gets $15 million upfront from J&J, up to $520 million in payments as certain goals are reached, and $200 million in development costs. J&J and Millennium will work to maximize Velcade's potential. Chris Raymond of Robert W. Baird, who rates the stock a strong buy, sees Velcade sales of $3.5 million in the second quarter. Still in the red, Millennium will lose 98¢ a share in 2003 and 75¢ in 2004, he figures. When first featured here, on Nov. 18, 2002, Millennium was at 8.

Bankrate: Bouncing Back From the Dot.com Bust

Bankrate (RATE) is one of a handful of Internet stocks that beat the odds. Under its old name of iLife, it went public before the bubble burst in May, 1999, at 13 a share. The stock promptly crashed—to 1 in August, 2002. It has since achieved the near-impossible: a rally to 14.29. Bankrate "staged an impressive turnaround and is in the midst of a strong growth cycle," says Charles Trafton of Adams, Harness & Hill, who rates it a buy. Through its Web site, Bankrate lists comparative rate tables and fee info on 100 financial products—such as mortgages, credit cards, auto loans, and money mar from scores of institutions. Revenues come mainly from tising. The turnaround came after Elisabeth DeMarse took control as CEO in 2000. "I told my staff the first goal was to make money," says DeMarse, who smartly led Bankrate to profitability: It earned 32¢ a share in 2002, vs. losses in 1999, 2000, and 2001. Trafton sees earnings jumping to 52¢ in 2003 and to 60¢ in 2004. DeMarse has streamlined operations and paid off debt. The rebound, says Trafton, boosted gross margins to 70% and operating margins to 23%. A hedge-fund manager who owns shares but asked not identified says Bankrate's peers sell at about 38 times 2 timates and 25 times 2004 numbers. Bankrate trades times 2003 estimates and 23 times 2004 forecasts. On Bankrate was added to the Russell 3000 and 2000 index

There's New Life At DaVita

DaVita (DVA), a major U.S. provider of k dialysis services, is on a tear. Its stock hit a 5 high of 27.58 on July 2, up from 19 in mid It's now at 27.37. Grant Babyak of Times Capital Management, which owns shares the runup is not over. With some 500 outpatient center states treating 45,000 patients, DaVita has turned aroun new management, led by Kent Thiry, took over in 1999. Several acquisitions years ago loaded DaVita with debt and caused it to miss earnings forecasts, leading to a federal probe. Since then, Thiry has installed controls and cleaned up the balance sheet. DaVita used $133 million from overseas assets sales to cut debt and improve credit. Babyak sees DaVita earning $2.09 a share in 2003 and $2.26 in 2004, up from $1.85 in 2002. His 12-month target: 35. William Bonello of Wachovia Securities says that as a big player in an industr predictable growth and stable reimbursements, DaVita' flow and earnings growth in 2004 should be strong.



BusinessWeek online Gene Marcial's Inside Wall Street is p at businessweek.com/today.htm at 5 the magazine's publication day, usually Thursdays. See Gene on Frida 1:40 p.m. EST on CNNfn's *The Money Gang*.

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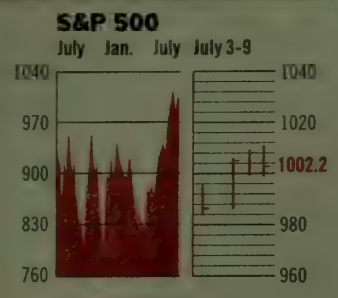
BusinessWeek Investor FIGURES OF THE WEEK

STOCKS



COMMENTARY

The markets continued to rise during the week ended July 9, confounding skeptics who question the basis for the ascent. Despite disappointing May inventory numbers on July 9, investors continued to bet on a rebound in the second half. Tech stocks, strong since the start of the year, continue to surge. Intel, up 50.8% in 2003, hit a new high.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	JULY 9	% CHANGE WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1002.2	0.9	13.9	5.2
Dow Jones Industrials	9156.2	0.1	9.8	0.7
NASDAQ Composite	1747.5	4.1	30.8	26.5
S&P MidCap 400	499.9	2.2	16.3	8.8
S&P SmallCap 600	233.7	3.4	18.8	7.6
Wilshire 5000	9652.7	1.3	15.7	7.4
SECTORS				
BusinessWeek 50*	588.7	–0.3	8.5	1.2
BW Info Tech 100**	323.2	1.9	13.2	9.2
S&P/BARRA Growth	509.2	0.5	13.5	7.7
S&P/BARRA Value	489.5	1.2	14.4	2.6
S&P Energy	194.3	–0.7	6.1	–8.7
S&P Financials	344.3	1.8	16.0	6.1
S&P REIT	103.2	0.9	13.7	5.0
S&P Transportation	180.7	1.1	6.3	–6.1
S&P Utilities	110.2	–2.1	12.8	–2.9
GSTI Internet	136.1	6.1	82.2	101.4
PSE Technology	599.8	3.7	30.9	26.7

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JULY 9	WEEK	% YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	945.1	2.8	11.
London (FT-SE 100)	4054.7	1.2	2.
Paris (CAC 40)	3139.9	2.0	2.
Frankfurt (DAX)	3322.4	2.5	14.
Tokyo (NIKKEI 225)	9991.0	4.2	15.
Hong Kong (Hang Seng)	10,027.4	4.4	7.
Toronto (S&P/TSX Composite)	7117.3	1.8	7.
Mexico City (IPC)	7171.9	0.1	17.

FUNDAMENTALS	JULY 8	WK. AGO
S&P 500 Dividend Yield	1.61%	1.65%
S&P 500 P/E Ratio (Trailing 12 mos.)	32.7	31.9
S&P 500 P/E Ratio (Next 12 mos.)*	17.5	17.0
First Call Earnings Surprise*	6.54%	6.50%

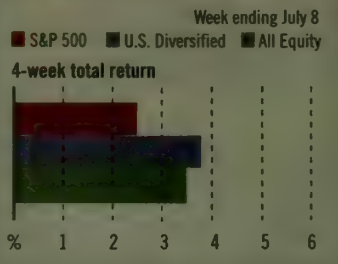
*F.

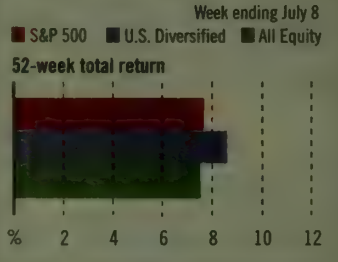
TECHNICAL INDICATORS	JULY 8	WK. AGO
S&P 500 200-day average	895.7	893.2
Stocks above 200-day average	87.0%	85.0%
Options: Put/call ratio	0.73	0.79
Insiders: Vickers NYSE Sell/buy ratio	4.20	4.15

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Internet Software	28.3	Internet Software	177.9
Wireless Services	21.5	Wireless Services	107.2
Internet Retail	18.4	Biotechnology	90.5
Electric Mfg. Svcs.	16.1	Office Electronics	80.3
IT Consulting	14.5	Comptr. Stge. & Perphs.	50.6

WORST-PERFORMING GROUPS	LAST MONTH %		L MO
Motorcycles	–11.3	Tires & Rubber	
Photographic Products	–11.2	Health-Care Facilities	
Tires & Rubber	–7.4	Automobiles	
Oil & Gas Drilling	–7.3	Steel	
Home Furnishings	–4.7	Food Chains	

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Japan	12.9	Communications	29.0
Diversified Pacific/Asia	8.9	Health	25.8
Pacific/Asia ex-Japan	8.6	Technology	25.4
Technology	7.8	Small-cap Growth	14.6
LAGGARDS		**LAGGARDS**	
Natural Resources	–3.0	Japan	–10.4
Europe	–0.4	Diversified Pacific/Asia	–6.0
Utilities	0.9	Foreign	–4.8
Domestic Hybrid	1.1	Europe	–3.7

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
PFds. Wrlss. Ult. Serv.	27.4	Jacob Internet	124.6
PFunds. Ultra Japan Inv.	25.8	PFds. Biotech Ult. Inv.	100.6
Apex Mid Cap Growth	21.1	Amerindo Technology D	98.1
The Japan S	18.5	Fidelity Adv. Lvgd. Co. A	90.0
LAGGARDS		**LAGGARDS**	
PFds. UltSh. OTC Inv.	–14.1	Rydex Dynam. Vent. 100	–61.8
Rydex Dynam. Vent. 100	–14.0	PFds. UltSh. OTC Inv.	–61.7
Rainbow	–8.3	Potomac OTC/Short Inv.	–35.4
Fidelity Sel. Egy. Serv.	–8.2	Rydex Arktos Investor	–33.2

INTEREST RATES

KEY RATES	JULY 9	WEEK AGO	Y
MONEY MARKET FUNDS	0.68%	0.70%	
90-DAY TREASURY BILLS	0.88	0.86	
2-YEAR TREASURY NOTES	1.33	1.28	
10-YEAR TREASURY NOTES	3.68	3.64	
30-YEAR TREASURY BONDS	4.70	4.58	
30-YEAR FIXED MORTGAGE†	5.53	5.47	

†BankRa

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-
GENERAL OBLIGATIONS	3.44%	
TAXABLE EQUIVALENT	4.91	
INSURED REVENUE BONDS	3.55	
TAXABLE EQUIVALENT	5.07	

THE WEEK AHEAD

RETAIL SALES *Tuesday, July 15, 8:30 a.m. EDT* ▶ Retail sales probably grew by 0.4% in June, while sales excluding vehicles most likely increased by 0.2%. That's based on the median forecast of economists surveyed by MMS International.

BUSINESS INVENTORIES *Wednesday, July 16, 8:30 a.m. EDT* ▶ May inventories probably rose by 0.1% for a second straight month.

CONSUMER PRICE INDEX *Wednesday, July 16, 8:30 a.m. EDT* ▶ June consumer prices for goods and services are forecast to have inched up by 0.1%, after holding steady in May. Excluding food and energy, core inflation probably climbed 0.2% higher, following a 0.3% increase.

INDUSTRIAL PRODUCTION *Wednesday, July 16, 9:15 a.m. EDT* ▶ Output during June probably expanded by 0.1%, after a similar gain in May. The average operating rate most likely held at 74.3%.

NEW RESIDENTIAL CONSTRUCTION *Thursday, July 17, 8:30 a.m. EDT* ▶ Housing starts in June are expected to have increased to an annual rate of 1.74 million. Durin May, new home construction rebounc a pace of 1.73 million.

The BusinessWeek production index rose week ended June 28 to 196.6, up 3.4% year ago. Before calculation of the four moving average, the index climbed to 19

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MICROSOFT'S BOLD NEW PAY PLAN

Turning years of compensation policy upside down, Microsoft Corp. announced on July 8 that it would start issuing restricted stock to its employees instead of doling out stock options (page 24). This is a big deal. As Microsoft stock soared during the boom years of the 1990s, such stock options turned thousands of employees into so-called Microsoft millionaires. Restricted stock has much less upside potential. To help with the transition, the company has set up a program to let J.P. Morgan buy back the stock options Microsoft's employees already have been granted. And it will change its accounting procedures to expense the stock options it already issued.

Because of Microsoft's prominence, its actions will have a tremendous impact on the compensation debate nationwide. Many companies already were discussing whether or not stock options were a cost-effective way to motivate employees and top executives. Now, it may be a lot easier for companies to take the plunge and get rid of options. The pressure to cut back on options will intensify after the Financial Accounting Standards Board issues new rules, probably in spring 2004, requiring all companies to count stock options as an expense on their earnings statements, as Microsoft is planning to do.

It's certainly worthwhile for other companies to take a look at Microsoft's example. Restricted stock has the advantage of offering employees more certainty, even if there is less potential for a big win. It also means shareholders don't have to worry about massive dilution after employees exercise bi gains, as happened in the 1990s. Another plus: Grants stricted stock are much easier to value than options, si stricted stock is equivalent to a stock transfer at the price. That improves the transparency of corporate acc

Remember, though, that one size doesn't fit all in th Just because Microsoft has shifted to using restricte doesn't mean that everyone else should follow. Com have many choices when they set up compensation bonuses tied to personal or corporate performance, sto tions, restricted stock—and they should use a mix of all methods as needed.

For example, it may still be appropriate for many star use stock options when they are an essential spur for i tion, especially in Silicon Valley. A big carrot is neces persuade the best people to leave good positions at bi panies and come to work at risky new businesses. Stock offer the possibility of getting rich should a new outfit p be successful. That's highly motivating.

True or not, stock options are often blamed for s the 1990s excesses. Many companies used them indi nately, jumping on the options bandwagon just because one else was doing so. But as Microsoft's announcement out, management needs to think about the best way t pensate employees, not just follow the crowd.

CHINA: TREAD LIGHTLY IN HONG KONG

A riveting drama is playing out in Hong Kong. On July 1, half a million citizens took to the streets in what must rank as one of the most peaceful mass demonstrations in world history. The lengthy procession through the heart of Hong Kong shattered the myth that its denizens don't care about politics.

The immediate cause of the protest was opposition to proposed national security legislation that would have given the Hong Kong government broad powers to suppress dissent (page 36). More generally, the populace is dissatisfied with Chief Executive Tung Chee Hwa's mismanagement of the territory since he took power in 1997. Facing a hailstorm of criticism, Tung delayed passage of the repressive legislation and opened the door to further discussion of the security issue.

But the turmoil also has bigger implications. It raises yet more questions about Hong Kong's autonomy from China, since Beijing may have to play a visibly stronger role if it perceives that Hong Kong lacks political stability. Moreover, the protests are a major challenge to the Chinese leadership, including President Hu Jintao. Hu's worry is that the Hong Kong protesters—especially if they appear to win—could become a model and inspiration for much larger numbers of mainlanders.

Both Tung and the Beijing government need to mov fully. First, as long as Tung remains in office, he should forward on electoral reform. The Basic Law, Hong mini-constitution, makes clear that universal suffrage is Kong's goal. Tung so far has ruled out serious discussion issue. He should reverse course and promise to push th full, fair, direct elections as soon as possible.

For its part, Beijing needs to get the ineffective Tung office. The question is how. The best option may be for to quietly ask Tung to resign and then replace him with one who will defend Hong Kong's interests more effectiv lowing Hong Kong to become just another Chinese met is not in the best interest of either Hong Kong or Chin

At all costs, Beijing should refrain from underminin protests. Hong Kong's free press played an important blasting away the SARS coverup, for the good of China a world. Any such repression could badly damage China's national standing.

The world has a significant stake in the stability of Kong. It is a crucial trade and financial bridge betwe West and Asia. More important, a strong market ec that coexists with democratization in Hong Kong will good omen for China's future.

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CITI'S NEXT ACT

CHUCK PRINCE, Sandy Weill's top troubleshooter, is the unlikely choice to become CEO. Does he have the right stuff to lead the world's most important bank? PAGE 30

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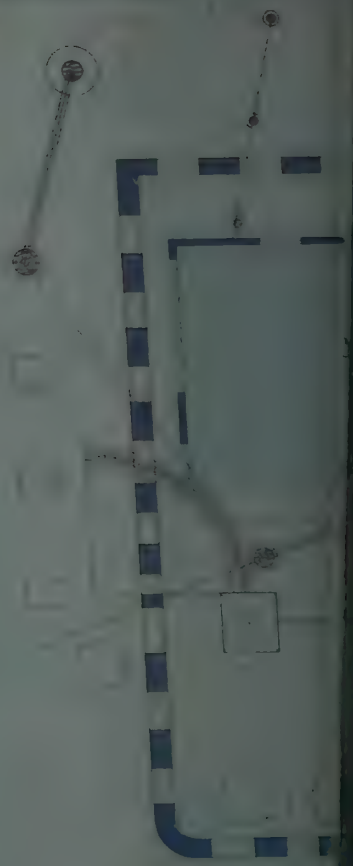

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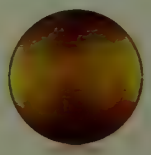
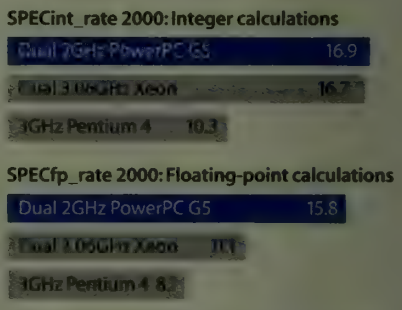


The PowerPC G5 chip. The world's first 64-bit processor for personal computers.



Independent tests show the Power Mac G5 edges out the competition on integer and blasts past them in floating-point.

In side-by-side speed tests using industry-standard benchmarks, the dual 2.0-gigahertz Power Mac G5 is up to 41% faster than both the fastest Pentium 4 and dual-processor Xeon workstation. And the results get even better when using real-world applications: the new Power Mac G5 runs Photoshop more than twice as fast as the fastest PCs. Further tests reveal there are similar gains across a wide range of applications, from music and video to science and mathematics.

The PowerPC G5 chip is based on IBM's highest performance 64-bit supercomputer processors.

Impressed? We haven't even touched on the Power Mac G5's other features. Like its ultrahigh-bandwidth system architecture, featuring AGP 8X, PCI-X, FireWire® 800, Gigabit Ethernet, up to 500 gigabytes (yes, that's half a terabyte) of internal Serial ATA storage and a SuperDrive™ for DVD authoring. All inside a stunning, professional-quality aluminum enclosure that features four discrete computer-controlled cooling zones for whisper-quiet operation. Together, they make the Power Mac G5 a true breakthrough in personal computing.

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CITI'S BOMBSHELL

REGIME CHANGE

A Citigroup without the strong-willed Sandy Weill at the helm seems almost unimaginable. How much control will he really surrender?

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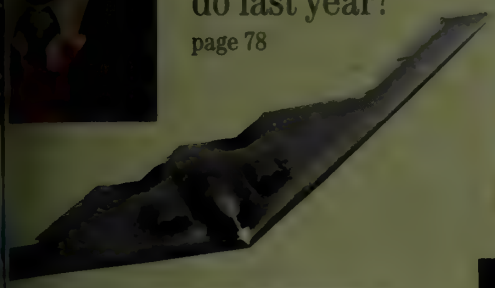

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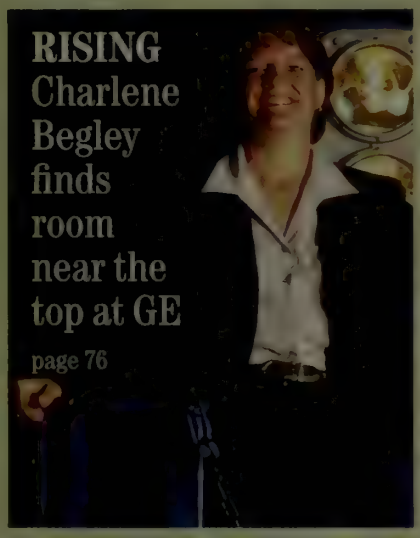

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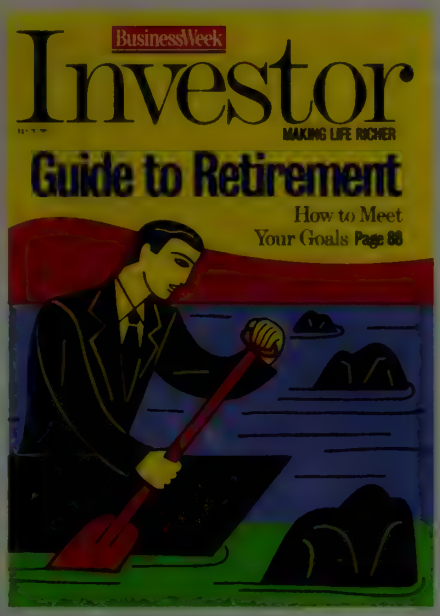

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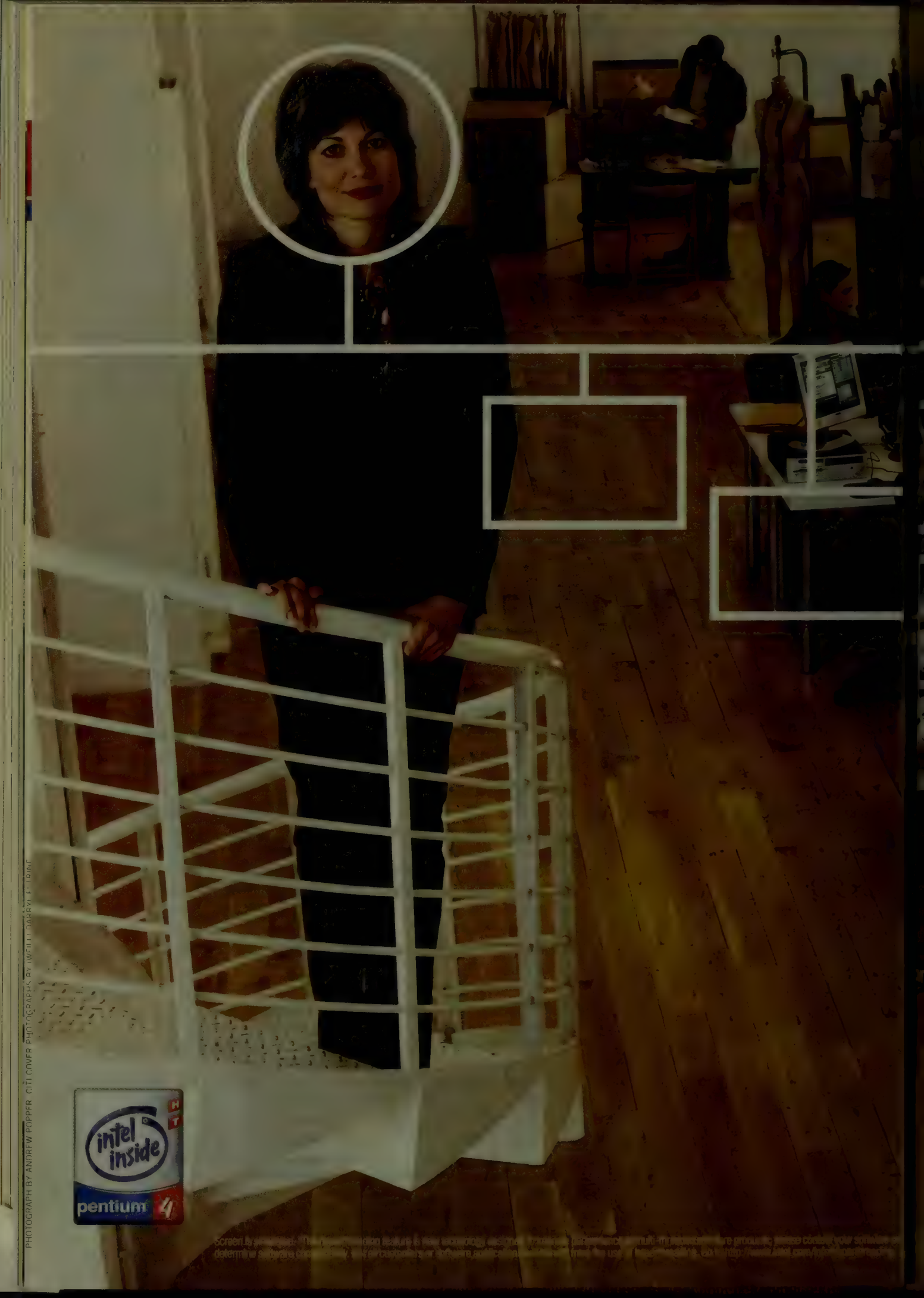

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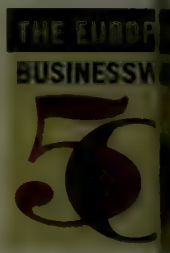

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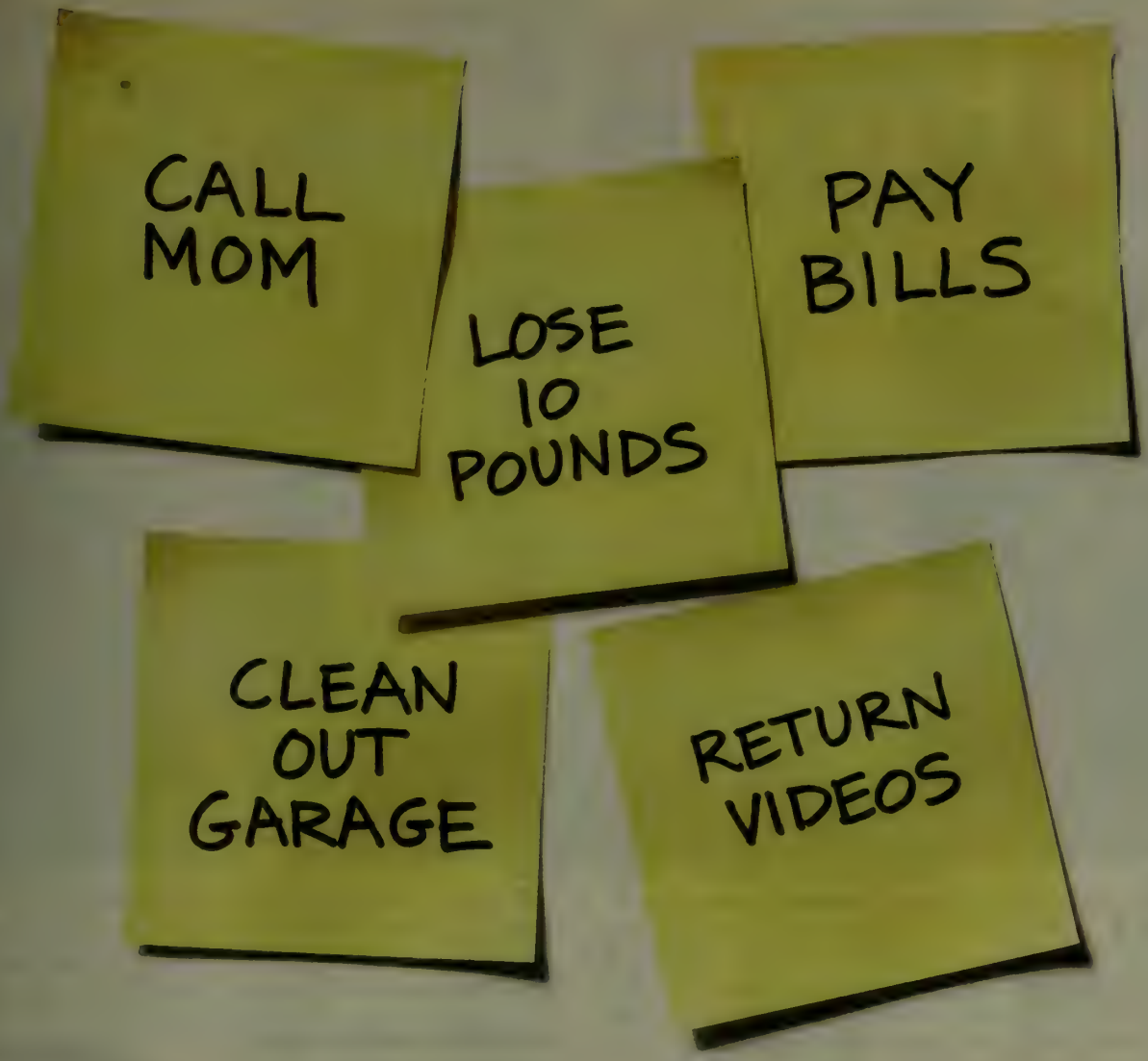

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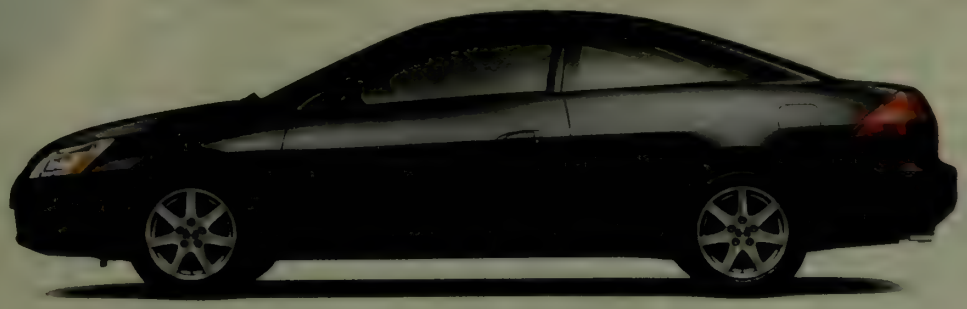

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Up Front

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WATCHDOGS

BAD OMEN FOR ORACLE

THE JUSTICE DEPT. ISN'T THE only agency looking into antitrust issues surrounding Oracle's $6.3 billion hostile bid for rival software maker PeopleSoft. Although only Connecticut Attorney General Richard Blumenthal has filed suit to block the deal, at least 30 state AGs have signed confidentiality agreements allowing them to share information.

The move doesn't mean all these AGs will take action. But it underscores the states' concern that the deal could be anticompetitive. Oregon is investigating, and others, including California and Texas, are reviewing the deal. "We're monitoring developments in the case," says a spokesman for the California AG.

There are other reasons Oracle may have trouble getting its mitts on PeopleSoft. Justice has already O.K.'d a $1.8 billion merger deal between PeopleSoft and J.D. Edwards. That bit of industry consolidation could close by July 18. Plus, PeopleSoft CEO Craig Conway and the board hold a poison pill that could make an Oracle deal prohibitively expensive.

Oracle says it remains fully committed to its PeopleSoft bid, "with or without J.D. Edwards." And Oracle CEO Lawrence Ellison told analysts on July 9 that he's willing to wait until spring, when four of PeopleSoft's seven directors come up for reelection. He joked: "At one point, Craigie thought I'd kill his dog. But if Craigie and the dog were standing next to each other and I had only one bullet...it wouldn't be for the dog." A PeopleSoft spokesperson called Ellison's comments "inappropriate and shocking." *Jim Kerstetter*

THE LIST DODGING THE TAXMAN

Aggressive use of corporate tax shelters cost states as much as $12.4 billion in 2001. That's more than a third of the total taxes that states were able to collect from corporations that year. A look at some of the hardest-hit states:

STATE	LOST REVENUE (in millions)	STATE	LOST REVENUE (as % of state budget)
CALIFORNIA	$1,340	WEST VIRGINIA	58%
ILLINOIS	693	OHIO	57
TEXAS	607	FLORIDA	49
PENNSYLVANIA	582	MISSISSIPPI	43

Data: Multistate Tax Commission

TALK SHOW "I am the biggest beneficiary of the payo almost $300 million. So I better be happy."

—Saudi Prince Alwaleed bin Talal, Citigroup's largest shareholder, on the company's decision to increase its annual dividend to $1.40 from $0.80

GLOBAL ECONOMY

UPBEAT ABOUT DOWNGRADES

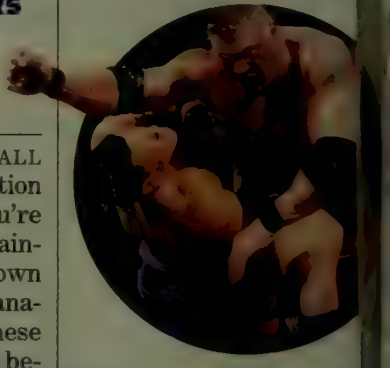
SMILE, ALAN GREENSPAN—THE news is even better than you thought. On July 15, the Federal Reserve chairman told Congress that a slowdown in the pace of corporate debt-rating downgrades is a good sign for the American economy. But it's not just in the U.S. that credit quality is stabilizing. According to data from Standard & Poor's, the trend is global.

GRIN: *Greenspan*

In S&P's second-quarter summary of the creditworthiness of the world's corporations, the number of downgrades per upgrade— 1—was the lowest sinc first quarter of 2000. I year's first quarter, the was 4.6 to 1. With econ improving, "we're clearl the trough," says Diane za, S&P's head of fixed-i research. (S&P and *Bus Week* are un The McGra Companies, I Europe, America, and da had the bi credit imp ments. But Asia-Pacific r worsened be of weak econ and SARS. The was in the m at 3.1 to 1. Moody's Inve Service and Fitch Ra don't do global reports they show similar trend the U.S. *Peter*

DESPERATE MANEUVERS

WRESTLING'S HAIL MARY PLAY



WHAT TO DO WHEN WALL Street stops paying attention to your company? If you're World Wrestling Entertainment, you become your own analyst. With only one analyst covering the stock these days, on July 7 the WWE began posting on its Web site weekly performance metrics—TV ratings, pay-per-view buys, and audience totals. "We're going to act like we're our own analysts," says Chief Financial Officer Phil Livingston.

It's quite a dramatic turn for WWE, once one of the Street's hottest growth stories. TV ratings for WWE's flagship shows, *WWE Raw* and *WWE SmackDown!*, have sunk 15% and 20%, respectively, since 2002. Pay-per-view buys for WWE's special events—a key profit center—have dropped more than 18% over the past year. And audiences for live matches in the U.S. have dwindled from last year, to about per event. The com blames reality TV for sip ing off viewers.

WWE's guidance is ha upbeat: It sees audience revenue declines in fisca Still, the company has million in cash, with about $9 million in debt. it just announced a 4¢ quarter dividend. Hove at $10 a share, the s yields about 1.6%, the s as some money-market f these days. So is WWE a s for widows and orph That's a story line not Vince McMahon could imagined. *Brian H*

Roger LeBrun,
Verizon Customer Service Technician/ Extreme Rescue Specialist on training exercise Malibu, CA

VOLUNTEER OR SOMETHING YOU LOVE

Last year, Verizon employees volunteered in 18,300 different ways, including helping people out of tough situations with the Malibu Mountain Rescue Team. Throughout the country we helped people make progress in areas ranging from literacy to acquiring job skills and bringing technology into communities.

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Up Front

TAXING MATTERS

A BIG WINDFALL FOR SMALL BIZ

THE BUSH ADMINISTRATION'S recent tax cuts are having an unintended effect: They're encouraging entrepreneurs to sell their companies. The cut in the capital-gains tax from 20% to 15% means most sellers can pocket an extra 5% of the sale price of their businesses. "I think this is going to have a huge effect," says Beatrice Mitchell, co-founder of investment bank Sperry, Mitchell & Co., which specializes in midsize outfits. "I've already had a couple business owners say, 'Maybe the pricing isn't quite what I wanted, but with the extra 5% I'll do it.'"

There's another bonus in the tax package. Many entrepreneurs nearing retirement age choose to invest the proceeds from a business sale into dividend-paying stocks—and the dividend tax is now 15%, down from a high of 38%. Together, the two tax cuts give a little breathing room to entrepreneurs worried about maintaining their lifestyle after a business sale.

Business owners have reason to be cautious, though. After a rough 2001 and 2002, many are waiting to book a few strong quarters before putting their companies on the block. "You'll probably start seeing an uptick in deals closing into the fall and hopefully into 2004," says Andrew Sherman, a partner with attorneys McDermott, Will & Emery. And maybe an uptick in satisfied sellers, as well. *Kimberly Weisul*

REALITY CHECK

IS THE THIRD SHIFT PULLING ITS WEIGHT?

EVER SINCE THE ADVENT OF the light bulb, employers have seized on all-night operations as an inexpensive way to boost productivity.

COSTLY: *Burning midnight oil*

But the all-nighter might not be a bargain. A new study by consultancy Circadian Technologies estimates night workers cost companies $206 billion annually—$8,600 per worker. No matter how many espressos night owls belt back, their bodies tell them it's time to sleep. Circadian found that graveyard-shift workers make five times as many mistakes, have 20% more accidents, and have costlier medical problems. "The best third-shift worker could never match your day worker," says Tracy Morgan, human resources manager for Meriden (Conn.) filtration company Cuno.

Companies that hesitate to acknowledge fatigue could face big legal judgments. In March, 2002, a lawsuit forced Conrail to pay $52.4 million to the family of an employee accidentally killed by a worker who only had four hours' sleep. Now that might just keep some CEOs up at night. *Kate Hazelwood*

DRAWN & QUARTERED

I-WAY PATROL

WEAPONS OF MASS ENTERTAINMENT

WHILE THE SEARCH GOES ON for weapons of mass destruction in Iraq, Web surfers are having no trouble finding comic relief in the U.S.'s elusive motive for war. A Web site spoofing the so-far-fruitless search has become one of the easiest—and most popular—to find on the Net.

WMD: *Hard to find*

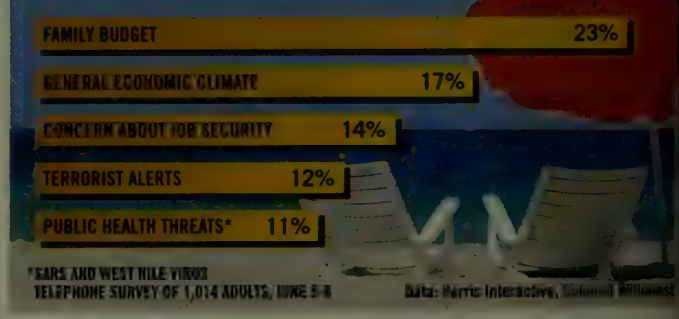
Type "Weapons of Mass Destruction" into a search engine like Google, Yahoo!, or MSN, and a satirical site is the first result listed. The link goes to what seems like a standard-looking error page, only the text reads: "These Weapons of Mass struction cannot be played." It goes on to gest the country ma having "technical difficul

The search engines nothing to do with the The satirical page, deve by a 34-year-old British macist, has so thorou trafficked— 1,000 visitors minute—t many search automatically clude it's the relevant on subject. "I surprised at quickly it spr says Anthony Cox, the creator. According to Go four times as many Web link to the gag site as t White House's weapon mass destruction stra page. *Ben*

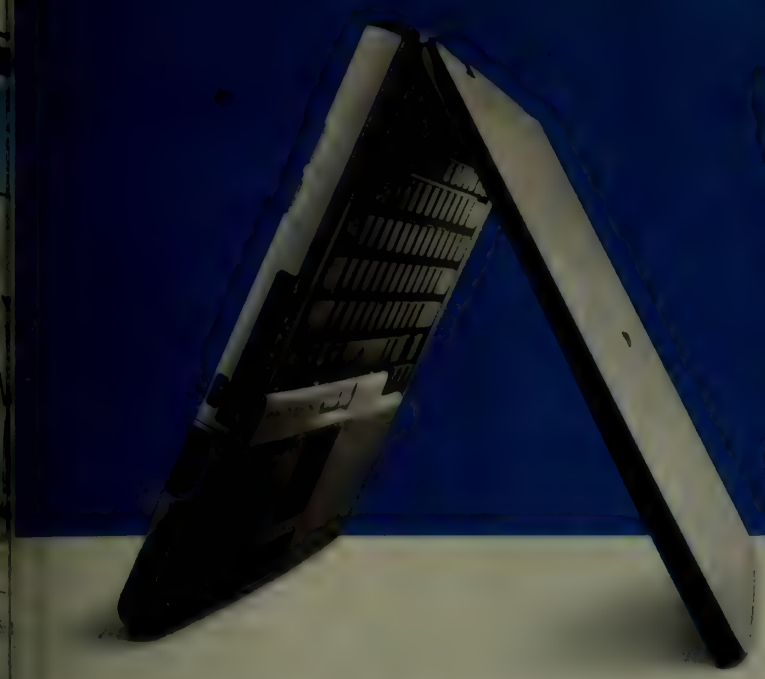
THE BIG PICTURE

NO VACATION FROM THE BAD ECONOMY

About half of Americans say they won't take a vacation this year. And not because of West Nile Virus or terrorist alerts. The percentage of people who said their vacation plans were greatly influenced by:



Polls, surveys, and other items for consideration in this section should be sent to **upfront@businessweek.com**



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Readers Report

LAFLEY: EMBRACING PROCTER & GAMBLE ALUMNI

"P&G: New and improved" (Cover Story, July 7) could not have been written before Alan G. Lafley's chairmanship. Before Lafley, no reporter had the access to Procter & Gamble's chairman and senior management, upon which you built such a complete picture of the company.

Lafley's commitment to outreach also includes a new approach to P&G alumni. Twentysome years ago, a loose P&G alumni network arose, and 500 alums came to a weekend reunion in Chicago. In the next two decades, P&G's attitude toward this group was "out of sight, out of mind." In June, 2000, a fourth reunion in Chicago occurred just two days after Lafley became president. Attendees were literally struck dumb when he arrived unannounced at the dinner party—and stayed. Lafley apparently sees value for P&G in embracing its alumni.

In April, 2003, another weekend alumni reunion was held, this time in Cincinnati and with deep involvement by P&G and by Lafley himself. This attitude shift has resulted in two alumni board members. Who knows what other benefits may accrue?

John Thomas
Winnetka, Ill.

BOEING'S DEAL: THE PENTAGON WOULD PAY INTEREST EITHER WAY

The venerable Office of Management & Budget argues that Boeing Co.'s proposed aircraft leases to the U.S. Air Force will cost more than a direct purchase ("Inside Boeing's sweet deal," Government, July 7). Could be, if the U.S. Treasury had the cash to purchase the aircraft outright, which it doesn't. Instead, the Treasury will go to the debt markets and issue more interest-bearing T-bills and notes to fund the lease ments (or the cash purchase). In case, the Treasury will be paying a plicit interest rate for the new airc

John D. H
President (Re
Harris Leasing
D

THE GOOD NEWS ABOUT CHRYSLER

Your commentary ("Chrysler's leap of faith," The Corporation, Ju is not balanced, omits key facts paints an incomplete picture of the a ongoing, and successful efforts to t form Chrysler Group into a world competitor in a fierce global marke

While your writers express the ion that Chrysler Group has a labo plant surplus, they could have ack edged that during the past 30 mo we have taken decisive, albeit pa actions to bring our capacity and re costs in line. Our workforce has reduced by more than 26,000 em ees, including some 19,000 hourly ers. Seven plants have been idled. eral component operations have folded into joint ventures, and satellite operations, such as DC Avi and an assembly plant in Europe, been sold. Furthermore, all of this accomplished while working with unions and maintaining productive relations.

Similarly, a chart refers to a purp "productivity problem" without any tion that Chrysler Group led the ind with an 8.3% improvement in the cently published *The Harbour Repor* was, in fact, the second-highest lev improvement ever recorded by Har

Your commentary is also sharply ical of our leadership team. The provements made since President

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BWK7/03

CORRECTIONS & CLARIFICATIONS

"This is the dawning of the Age of—XM?" (Information Technology, July 7) stated that Sirius Satellite Radio Inc. is "completely commercial-free." While this is true for the broadcaster's 60 music channels, most of its 40-plus talk channels do carry ads.

In "The Samsung way" (Cover Story, June 16), one of the charts understated the company's operating profits. Samsung earned $110 million in its digital-appliances business and $320 million in digital media.

Chief Executive Dieter Zetsche arrived less than three years ago to take the helm are significant and numerous. Let me focus on two of them: 1) Quality. The 20% improvement in warranty expense achieved in just the 2002 model year is four times the improvement seen in any of the previous five years, and we're on track for a double-digit improvement this year as well. 2) Product. Since 2001, our company has launched the successful Jeep Liberty and Dodge Viper, the Dodge Ram, the Chrysler Pacifica, and Chrysler Crossfire. In a recent issue, *BusinessWeek* called the Crossfire "the most attractive car in a competitive segment."

With the entire U.S. auto industry struggling in a difficult and fragile economy, one might expect backseat commentary on the people driving the bus. But there's no excuse for *BusinessWeek*'s ignoring the road already traveled or the map we are using to drive into the future.

Kenneth A. Levy
Vice-President for Communications
Chrysler Group
DaimlerChrysler Corp.
Auburn Hills, Mich.

MANY PATIENTS LOOK FOR A WAY TO AVOID RESPONSIBILITY

Isn't it ironic that "most insurance companies cover and encourage multiple consultations" ("To cut—or not to cut?" BusinessWeek Investor, July 7)? When I happen to be the third or fourth physician consulted by such a patient, I realize that he or she is looking for validation of a refusal to follow medical advice. In your list of "overdone" surgeries, 10 of the 14 procedures are usually done to treat diseases of lifestyle that are related to obesity and smoking. Maybe we should start promoting personal responsibility instead of blaming others for our ill health. Patients would likely value their health more if they realized that medicine may not be able (or willing) to fix the damage they do to themselves.

Sharon A. Sutherland, M.D.
Cleveland

CITY AND STATE COLLEGES: A LIFELINE BASED ON MERIT

Re "Needed: Affirmative action for the poor" (Economic Viewpoint, July 7): What world does Laura D'Andrea Tyson live in? I grew up poor in New York and attended Brooklyn College for free because of my grades, not the color of my skin or my religion. Many successful people who couldn't afford Ivy League schools graduated from city and state colleges. Poor blacks or Latinos have the opportunity to go to these schools based on their abilities. Does Tyson have such disrespect for these people that she thinks they can't do anything without affirmative action?

Beverly Levy
Allentown, Pa.

THE BILL AND HILLARY SHOW KEEPS GOP COFFERS FULL

Re "Two mirrors on the Clinton years" (Books, July 7): You just don't understand. You say of Hillary Rodham Clinton: "The media, and the vast right-wing conspiracy, would do well not to underestimate her. Again." But since the veil was lifted on her in 1993-94, the GOP has held the House, which it hasn't done for 40 years. The best way to keep the Libs and the Dems out of office is to have Bill and Hillary stay visible and in the fray. She can have her 40%, which is all she can get. They make raising money so easy.

We love Bill and Hillary. Understand?

Norman Berger
Menlo Park, Calif.

DON'T GIVE UP YET, GENERATION X

"For Gen X, it's paradise lost" (Social Issues, June 30) talks about how difficult Gen X has it in the workforce and how Harvard University grads can't get a job. Hate to say it, but it doesn't matter if you got your degree from Harvard or a state college—if you aren't going to fight your battles when they hit you in the face, your esteemed Ivy League education is worthless. The people of Gen X are still young. They still have fight... and they can win. Generation X doesn't have to be remembered for what it lost; it can be remembered for what it took back!

Ryan L. Hawk
Sidney, Neb.

HOW CAN LANCE BE BAD FOR BIKING?

Lance Armstrong's recovery fr
cer and subsequent success in th
de France has done nothing les
increase global awareness of an
wise marginal sport ("Is Lance j
good?" News: Analysis & Comm
June 30). As with the New York Y
in baseball, the Chicago Bulls of M
Jordan-era basketball, and, indeed
cycling greats who previously don
the Tour, the public always seems
that mastery equals viewing bore

One must remember, as man
liant young cycling stars right n
doing, whoever dethrones Armstro
go down in history as having u
in a new era in a sport that is no
ally famous. What sponsor wouldn'
to be front and center then?

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PROTECTING AMERICA'S HEALTH
The FDA, Business, and One Hundred Years of Regulation
By Philip J. Hilts
Knopf • 394pp • $26.95

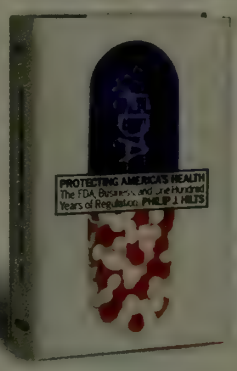
THE HUNDRED YEARS' WAR AT THE FDA

When new drugs to treat life-threatening heart rhythms came on the market in the 1980s, the medical community made a logical leap. If the medicine worked in serious cases, doctors reasoned, then it must also work in cases of mild irregular rhythms, which are far more common. The drugs quickly became the standard of care for these milder cases—even though they had never been tested for those conditions.

Scientists finally performed a rigorous clinical trial later that decade, despite the protests of physicians. Doctors argued that denying the drugs to some patients, by giving them placebos, would be unethical and immoral. However, the results showed that, far from saving lives, the treatment was killing thousands of people every year. It was "arguably the worst drug disaster in American history," writes veteran *New York Times* science and health reporter Philip J. Hilts in his often fascinating new history of the Food & Drug Administration, *Protecting America's Health: The FDA, Business, and One Hundred Years of Regulation.* The lesson: to look after the public and advance medicine, there's no substitute for scientific testing. And to get the proper tests done requires a strong regulatory agency.

That may seem like a no-brainer. But as Hilts documents, Washington only gradually instituted the food and drug safeguards we now take for granted—and it did so only after deaths and other tragedies forced its hand. Moreover, industry executives and conservative politicians screamed in protest every step of the way and tried regularly to strip the agency of its hard-won powers. Even now, the FDA is largely forced to sit idly by while dietary-supplement makers sell dubious or potentially dangerous nostrums, such as the herb ephedra, because the agency lacks the authority to regulate the industry. Hilts tells the sad tale of Jennifer Bilger, who, in the mid-1990s, lost her unborn baby after drinking tea made from pennyroyal that she got from her Boston food co-op. Even ancient Greeks knew the herb induced abortions, so "it is difficult to understand why potent drugs such as pennyroyal...should be permitted to be sold without even the hint of a warning to consumers," Hilts writes.

But it was once far worse. At the end of the 19th century, Americans were regularly being poisoned by food and what passed for drugs. "The corruption in the food and drug trade was unlike anything seen at any time in history," Hilts observes. Chemicals were poured on food to make faded vegetables appear green and to cover the evidence of rot. Brown sugar was cut with ground-up lice (which looked just like sugar), and flour with chalk or plaster of paris. Medicines contained everything from arsenic to cocaine, with no hint of what the ingredients were. When Harvey Washington Wiley, an Agriculture Dept. chemist and a pivotal figure in the FDA's creation, fed commonly used preservatives and other chemicals to volunteers (and himself) at fairly low doses, everyone got violently ill.



Pushed by Wiley and other reformers, in the early 1900s the House of Representatives passed bills to make food and drugs a little safer. But the bills were killed by Republican Senate leaders, who argued—in a foreshadowing of a century of right-wing attacks on regulation—that government had no business meddling in business. Not until journalists exposed how infants were being killed by cocaine-containing "soothing syrups"—and after Upton Sinclair vividly described sausages made from rotting, rat-feces-covered m... his novel *The Jungle*—did Washi... act. In 1906, Congress create... agency that would become the F... Drug Administration. Its regulator... enforcement powers were limited... this was a fundamental change in... Hilts argues, "an assertion that i... the job of the government to p... citizens from some kinds of com... rather than just to protect comm...

Thus began the agency's tumu... history, marked by a constant st... between the foes and advocates o... ernment oversight. It took 107 ... from a liquid antibiotic preparation... highly toxic diethylene glycol (a... mon ingredient in today's antifree... get Congress to pass a landmark... law. At last, before a product co... sold, a company would have to s... data proving that it was safe. Sim... the thalidomide tragedy... early 1960s resurrected... tempt by Senator Este... fauver (D-Tenn.) to add... consumer protections... terrible birth defects b... known, Kefauver an... Kennedy Administration... able to push through the... startling idea—bitterly... posed by the American... ical Assn. as wel... conservatives—that... should be tested to see if they ac... work before they can be sold.

In addition to these events, ... chronicles the tension at the agency... struggled to find a balance bet... tougher and looser rules. Indeed... FDA is often simultaneously accus... moving too quickly and too slow... early July, for instance, it won both... dits and criticism from consumer g... for requiring new data about fat o... labels—at the same time that it all... more health claims by food produc... wish Hilts had more explicitly ana... how and why the pendulum has s... between more and less FDA regul... But his story is compelling, and it ... with a powerful message: that A... cans are hugely in debt to the refo... who gave the agency its powers... to the usually unappreciated bureau... toiling away in the trenches.

BY JOHN C...

Senior Correspondent Carey c... the FDA from Washington.

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BY STEPHEN H. WILDSTROM
tech&you@businessweek.com

LOSE THE EXTRAS ON THESE DVD PLAYERS

Recreating the complexity that kept some VCR owners from ever recording anything

I watch DVD movies at home on a $75 Mintek player. There's nothing fancy about it, but it does all I want. The DVD players' incredibly rapid run from pricey novelty to cheap commodity has consumer-electronics makers scrambling for ways to put premium value back into these products. My experience suggests, however, that this may not be the best thing for consumers.

I tried out two of the newfangled players: the D2730 Networked DVD Player from GoVideo (once part of the now-dismembered SONICblue) and the $599 Panasonic DMR-E60S DVD Video Recorder. Both are very good high-end players, and both include premium features such as progressive-scan output, which generates better quality pictures for high-definition monitors. But the two products differ radically in their efforts to go beyond the standard player.

The $299 GoVideo unit is part of a growing trend of adding Ethernet networking capability to consumer-electronics products. After you install software on one or more Windows PCs in your house and plug in a network cable (or install an optional Wi-Fi wireless card), you use your television to select music or view videos or photos stored on your PCs. The networking setup is very simple—actually easier than connecting the DVD player to a TV or home theater. And for music, the GoVideo player will use the catalogs and playlists set up by standard PC applications such as MusicMatch Jukebox or Windows Media Player. The results with video will depend on the quality of the recording and the speed of your network. Video that is acceptable when viewed in a window on a computer display can look horrible on a big TV set. And except for the brand new Wi-Fi adapters, the wireless networks are not fast enough for high-quality video.

These network functions are modest and available in other products such as TiVo Series 2 and ReplayTV personal video recorders. Still, you may find them useful in a DVD player. Since they come at a relatively small premium of perhaps $100 over a nonnetworked high-end player, the GoVideo unit can be considered a good

The $599 (substantial discounts may be able) Panasonic DVD recorder could despe use a network connection. It tries to fill th between increasingly obsolete video cas recorders and hard-disk based personal recorders. Unfortunately, it mostly just ates the complexity that has kept millio VCR owners from ever recording anythin beauty of personal video recorders, whic program guides from the Internet, is simp Find the show you want on an on-screen press a button, and you're set.

The Panasonic recorder makes you ent time, date, and channel you want to record VCR+ code). If you want the recording on I have a title, you must enter it manually. An recorder offers no way, such as an "IR bl that simulates a remote, to control a digita top box or satellite receiver. So if that's you get your television, you must set the cl manually in advance. The lack of a pro guide and the inability to control other devi especially frustrating when you realize tha Panasonic recorder costs more than a Ti ReplayTV with a lifetime service subscript

The advantage of the DVD approach is t produces recordings that can be played where. This is diminished somewhat by sonic's choice of the DVD-RAM format, rather the more popular DVD+RW or DVD-RW. DVD mainly used by professionals for video-file age, has some plusses: It offers the a (shared with hard disks) to play one rec show while capturing another, and the abil

DMR-E60S
In desperate n of a network connection

edit on disk. Unfortunately, editing on-screen using a remote control is painfully crude, and the DVD-RAM disks won't work in most non-Panasonic players. You can also record to write DVD-R disks, which will work in most player you lose the advanced features.

I ended up using the Panasonic recorder ly as a tool to make archival copies of sho had recorded on my ReplayTV. What I w want is a setup that incorporates the recorder, so that all I would have to do is a recorded show on the Replay or other and click a "save to DVD" button to cre permanent copy.

These early attempts to integrate com technology into consumer electronics prove we still have a long way to go. The attracti convergence is compelling. We just need b easier-to-use products.

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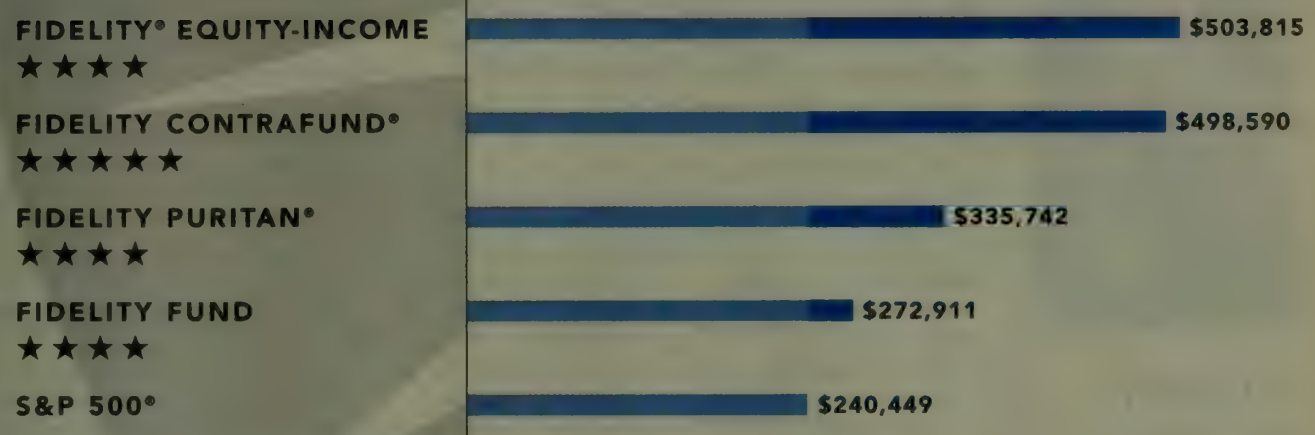

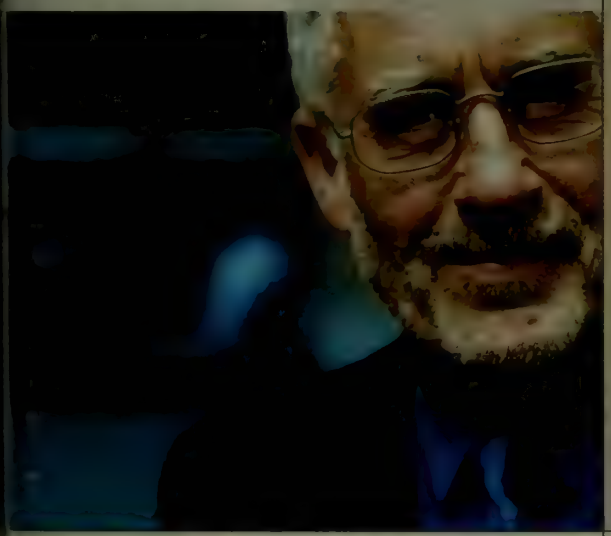

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BY ROBERT KUTTNER

WELCOME TO THE AMAZING JOBLESS RECOVERY

NO WAY: It will take 340,000 new jobs a month to get back to near-full employment by late 2004. Sadly, there's little chance of that happening

Is a robust recovery just around the corner? Optimists and defenders of the Bush economic program point to some fine print in the Labor Dept.'s otherwise grim June unemployment report and to the resurgent stock market (which often leads recoveries). But both indicators, on closer inspection, are fool's gold.

The unemployment rate is now 6.4%, a nine-year high. Optimists note that the rate of job decline has slowed and that the unemployment rate is up mainly because formerly discouraged workers are returning to the labor force. The Administration's tax cuts will provide about $200 billion of stimulus in the second half of 2003. All of this supposedly prefigures a real improvement on the labor front in the coming months.

But a closer look at the employment data suggests a bleaker picture. Since the recession began in March, 2001, the economy has shed a remarkable 2.7% of total jobs. That translates to 2.6 million jobs lost since George W. Bush took office. Meanwhile, the working-age population has grown by over 3 million.

That's by far the worst labor-market performance in the post-World War II era. Of the nine recessions since 1953, only four resulted in net job loss 27 months after the recession began (the counterpart of June, 2003). Out of those, only one recession had net job loss greater than 1%, according to a tabulation of Labor Dept. statistics by the Economic Policy Institute. That was the 1990-91 recession, which sank the current President Bush's father.

This time around, the Council of Economic Advisers is projecting that the latest "jobs and growth" tax reduction should add 1.4 million jobs between July, 2003, and November, 2004—on top of the 4.1 million new jobs that a normal economic recovery would produce. At more than 340,000 jobs a month, that compares favorably with the job creation of the sizzling 1990s. That's indeed what it will take to get back to near-full employment. But there is no good reason to expect a repeat performance anytime soon.

In fact, the economy needs to generate about 1 million jobs a year just to keep pace with population growth. In 2001 and 2002, it shed about 100,000 jobs a month. In the last few months, this has improved somewhat. In June, the economy lost only 30,000 jobs, for a total of 236,000 in the first half of 2003. But the number of people unemployed more than 20 weeks reached a 19-year high in June. And real median earnings have fallen for four straight quarters. If we counted as unemployed discouraged workers who have given up looking for a job and part looking for full-time work, the unemplo rate would be over 10%.

As Barry Bluestone, who directs the Cen Urban & Regional Policy at Northeaster versity, observes, one underlying problem the prodigious productivity growth that p the '90s boom has continued but without co ble growth in gross domestic product. That of course, that fewer workers are needed duce the same amount of goods and servic

The economy needs to grow at better th a year to get back to full employment. In 2003, it grew at just 1.4%. The stock m boom that ended in early 2000 produced rates of capital investment and produ growth. But nothing on the near horizo gests a rerun of the Roaring Nineties.

For the economy to escape the jobless-re trap, a virtuous circle of more investment man and physical capital, rising wages, a newed consumer spending will have to occ optimists see the stock market as heraldi such a path. But while there has been a r increase in both profitability and capital i ment, it isn't enough to justify even the rebound of the first half, much less a nev style bull market. The price-earnings mult the average stock is being reported at a 19, but that figure is based on rosy forecasts ture earnings. The p-e multiple based on th 12 months' earnings is 33, which is high taking into account today's low interest rat

The market could oscillate within a fairl row range, as wishful thinking dukes it ou post-1990s risk aversion and short-term taking. Flat purchasing power, meanwhile, industry little appetite to increase investme the vicious circle of industry trying to r earnings by cutting labor costs (jobs and w and consequently depressing its own mark likely to continue.

How can government policy help? The tax cuts will provide a spur, but any of s alternatives would have produced more sti and job creation for the same dollars. include public investment in education, res and health, relief to cities and states, payroll-tax reduction that would put mor the pocket of wage workers and lower th of new hires.

The Bush Administration cannot be bl for inheriting the dot-com bust. But it ca will be blamed for applying the wrong ec ic cure.

Robert Kuttner is co-editor of *The American Prospect* and author of *Everything for Sale.*

AMES C. COOPER & KATHLEEN MADIGAN

REENSPAN'S NUMBER ONE CONCERN: APITAL SPENDING

says business skittishness is holding back the recovery

U.S. ECONOMY Federal Reserve Chairman Alan Greenspan always deliv- his semiannual testimony on monetary policy in t of Congress and TV cameras. But his July 15 ch seemed geared to catch the ears of a specific au- ce: corporate executives, who are still sitting out recovery. Greenspan's message: Everyone else is on d—but businesses remain in the waiting area.

is consternation is understandable. Major sectors consumers and housing are pulling their weight. The White House has engineered a massive tax cut, and most important, financial conditions are the most favorable in decades. And yet, as the chairman said, "there is little evi- e that the more accommodative financial environ- has materially improved the willingness of top ex- ives to increase capital investment."

E FED'S VIEW OF THE FUTURE

	ACTUAL 2002	CENTRAL TENDENCY FORECAST 2003	2004
DP	2.8%	2.50-2.75%	3.75-4.75%
TION*	1.9	1.25-1.50	1.00-1.50
PLOYMENT (Q. AVG.)	5.9	6.00-6.25	5.50-6.00

TH-QUARTER TO FOURTH-QUARTER PERCENT CHANGES
*PERSONAL CONSUMPTION PRICE DEFLATOR
Data: Federal Reserve Board

eenspan seemed to suggest that progress in capi- pending will be the Fed's No. 1 benchmark in judg- its success at moving the economy into higher th. But he recognized that business leaders remain e circumspect" about taking on new investment cts, reflecting still ample capacity, lingering doubts t future demand, and the intense focus by the ic and regulators on corporate behavior.

e chairman sees a "pervasive sense of caution" g businesses despite improving financial condi- , profits, and the general outlook. That dark mood nues to weigh on the willingness of companies to e commitments to the future, whether it's buying a machine, laying in more inventories, or recalling laid-off workers. The bottom line: Until business ment brightens, this recovery will remain disap- ingly sluggish.

PORATE AMERICA'S reluctance to spend is prob- why the Fed sharply cut its growth forecast for from the projections it made back in February. "central tendency" of the forecasts of the Fed's n board members and the 12 district presidents growth this year in the range of 2.5% to 2.75%, from 3.25% to 3.5% (table).

second-quarter growth comes in at about 2%, as generally expected, then the Fed's forecast implies that growth will pick up to an annual rate of between 3.1% and 3.6% in the second half. That would be an improvement, but it would not likely spur much enthusiasm in corporate boardrooms. Executives want to see growth more in line with the 3.75% to 4.75% range that the Fed expects in 2004.

But a moderate pace of demand is not the only reason for weak capital spending. Executives remain skittish about corporate scandals ranging from Enron Corp. to the more recent Freddie Mac accounting problems. The Fed chief said that executives and boards of directors seem "unclear, in the wake of recent intense focus on corporate behavior, about how an increase in risk-taking on their part would be viewed by shareholders and regulators."

So instead of embarking on new capital projects, businesses are focusing instead on strengthening their balance sheets. And on that front, the Fed chief noted substantial progress: Reflecting the benefits of lower interest rates, the ratio of interest costs to net cash flow has fallen, and the average maturity of corporate liabilities has lengthened. Plus, the ratio of current assets to current liabilities has risen. These improvements have made investors willing to take on more risk, a key reason financial conditions are now more supportive.

Normally, cheaper capital on top of improving prospects for demand stemming from the recent tax cut would serve to increase capital spending. But Greenspan seems wary about whether this textbook mechanism will work the way it has in the past. He said spending patterns over the next few months "may provide an important test of the extent to which this traditional view of expansionary fiscal policy holds in the current environment." All this sounds as if the chairman is hoping for, but not betting on, a strong rebound in capital spending this year.

THAT CAUTION CONTRASTS SHARPLY to his upbeat read on consumers and housing. Indeed, in June, retail sales rose a healthy 0.5% (chart). Store sales have been climbing, thanks in part to money freed up by

mortgage refis, another offshoot of low rates. And spending will get a further lift now that the tax cuts and child-credit rebates are in place.

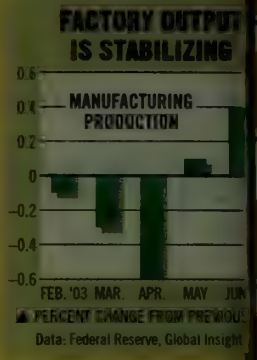
Greenspan pointed to a Joint Committee on Taxation estimate that consumers will see an extra $35 billion in the third quarter because of the tax changes. Stronger growth in demand should induce businesses to rebuild inventories. In May, inventories held by manufacturers, retailers, and wholesalers fell 0.2%, after holding steady in April.

A return to inventory accumulation will help the U.S. factory sector. Already, the industrial sector has stabilized, and a pickup in output growth would allow manufacturers to use more of their available capacity. That's another plus for capital spending, since businesses are unlikely to invest in new equipment until their existing facilities are all being used. In June, industrial production increased 0.1%. Factory output alone rose 0.4%, the second consecutive gain (chart).

WHILE GREENSPAN NOTED that all domestic sectors outside of business were providing momentum to the economy, he did recognize that rising energy prices and "lethargic growth" in the rest of the world posed downside risks to the outlook.

The divergent trends in demand between the U.S. and the rest of the world is causing American imports to grow much faster than exports. As a result, a widening trade deficit remains a drag on the U.S. econ In May, the gap increased again, to $41.8 billion, $41.6 billion in April. Unless the June deficit narr appreciably, the net export sector subtracted growth in the second quarter.

More worrisome is that the dollar's fall over the past year hasn't enabled U.S. manufacturers to gain a bigger toehold in foreign markets. Price-adjusted exports slipped 1.6% from a year ago, while real imports have shot up 6%. Those trends won't change much until other countries, most notably in the euro zone, begin to post better growth.



Until then, the U.S. appears to be the prime en of growth for the global economy. That's Greenspan drove home the idea that the Fed w keep monetary policy highly accommodative "fo long as it takes to achieve a return to satisfac economic performance." The chairman spoke that ph not once, but twice. He can only hope that the busi sector got the message that this recovery depends shift in executives' mind-set. For economic growt pick up, businesses need to start taking risks and b spending again.

BRITAIN

WILL LOWER RATES GIVE MANUFACTURING A BOOST?

The Bank of England's quarter-point rate cut on July 10, to a 48-year low of 3.5%, was surprising on two accounts. First, analysts expected the BOE's Monetary Policy Committee to wait until August, when its key inflation report is due. Second, the meeting was the first headed by new BOE Governor Mervyn King, whose reputation as an inflation hawk has earned him the moniker "Unswervin' Mervyn."

The official vote tally of the nine-member MPC won't be known until July 23, but King appears to have voted with the majority, given that the committee's stated rationale for the cut mirrored newspaper comments made by King only days earlier. The rate reduction implies that King will bring more flexibility to policymaking than popular impressions had suggested.

King, formerly the BOE's deputy governor, had expressed concern about weaker-than-expected growth and the recent upturn in the British pound, which could further harm exports and manufacturing output. British manufacturing suffered its worst year in a decade in 2002. It remains in recession, with output falling in May as exports to Europe sank to a four-year low.

Overall economic growth began 2003 at the slowest pace in 10 years. Now, consumer spending and housing, which had helped to offset the factory slump, are mo erating and the private-sector jo market is starting to soften.

With inflation already slowing there was little reason for the MPC to wait until its next inflatio report before acting. Retail infla tion, excluding mortgage interes dipped to 2.8% in June, down from 3% in April. That's slightly above the MPC's 2.5% target, but with the rise in housing prices now slowing, inflation is set to fi further.

British inflation measured by Europe's standardized index, the Harmonized Index of Consumer Prices, is running at only 1.1% in June, the lowest since September The MPC plans to adopt an HICP-based target later this year, suggesting that the committee may have more room to cut rates agai to assure a lasting recovery.

HYSICIANS TAKE THE IPPOCRATIC OATH. UDGES TAKE A ONSTITUTIONAL OATH.

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Lately, there's been a lot of turmoil in our industry. Hopefully, you haven't been affected.

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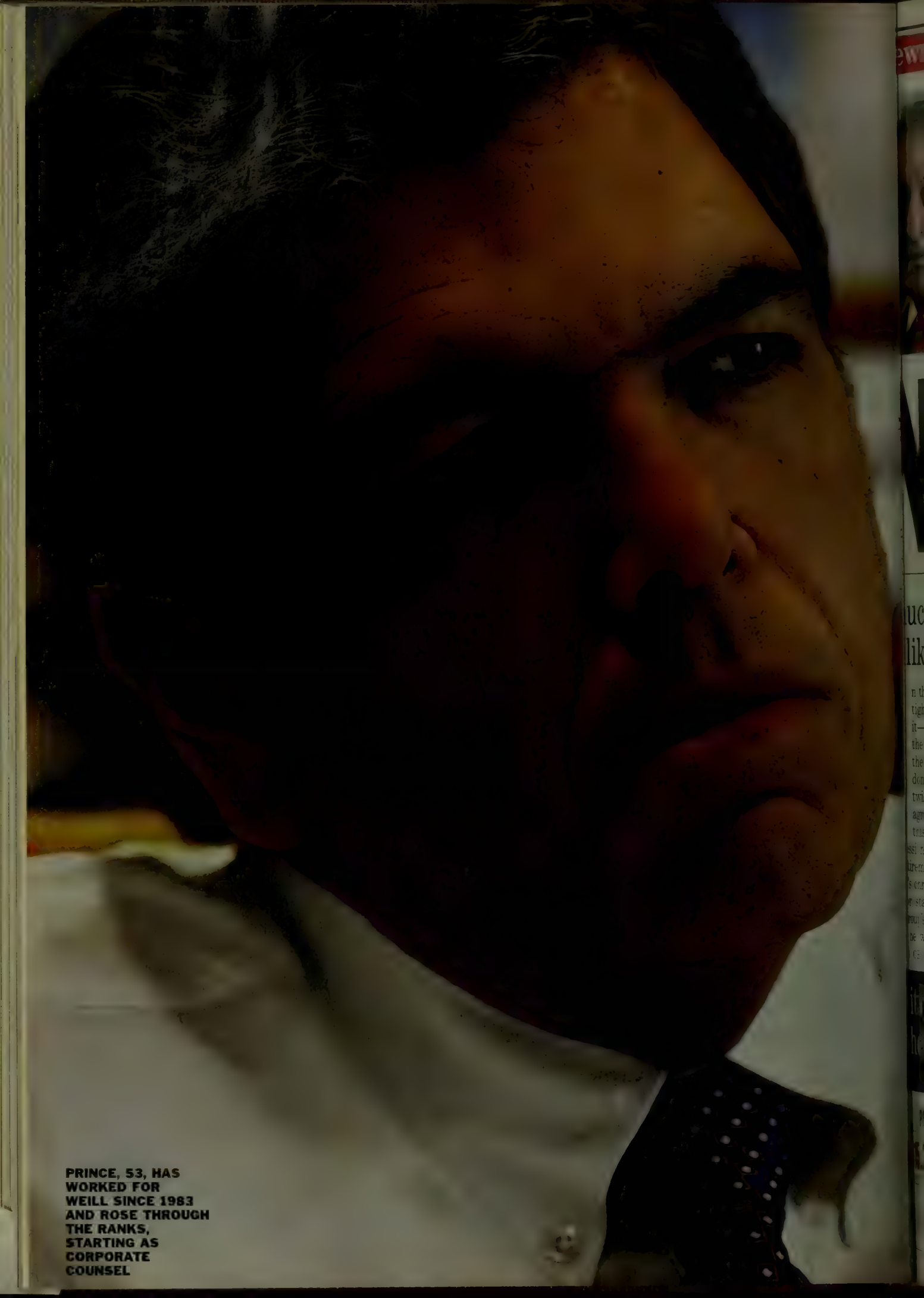


PRINCE, 53, HAS WORKED FOR WEILL SINCE 1983 AND ROSE THROUGH THE RANKS, STARTING AS CORPORATE COUNSEL

CITI'S NEW ACT

uck Prince, Sandy Weill's top troubleshooter, is the likely choice for CEO. Does he have the right stuff?

n the modern history of Wall Street, no one has held tighter to power—or made more productive use of it—than Sanford I. Weill, who built Citigroup, into the world's most profitable company. But on July 16, the 70-year-old Weill did something he had never done before in a four-decade career filled with more twists and turns than an Alpine slalom course: He agreed to step down as chief executive by the end of this year. Make no mistake, for Weill this is a major ssion. However, Weill's surprise move stops well short irement and by no means definitively solves the giant s chronic succession problem.

r starters, Weill plans to remain as chairman until oup's annual meeting in the spring of 2006. Weill insists he will not meddle with Charles O. "Chuck" Prince, CEO-in-waiting, or Robert B. Willumstad, who will move up to chief operating officer. Both Prince and Willumstad are senior Citi managers and longtime Weill subordinates. "I think I'm grown up enough to not get in the way of the authority that they have to have to really be good in what they are going to do," Weill said in a July 16 conference call. "These will be the guys running the business, and they had better not screw up," he added.

However, it is difficult even for many Weill admirers to envisage the famously strong-willed and Machiavellian executive as a passive sort of chairman, particularly when Citi's acquisition of Sear, Roebuck & Co.'s credit-card portfolio—a $3 billion deal announced on July 15—seems to presage a return to a strategy of growth by acquisition, Weill's forte. "If I was a board member I'd scratch my head and wonder if this really isn't just Sandy saying I'm going to give it up, but really keep it...," says a top Wall

tigroup by he Numbers

Sandy Weill's creation is a global powerhouse by any measure. Here's how it ranks against all companies worldwide, except for assets, where it is compared with global banks. All figures are for 2002, except for market capitalization, which is based on the July 16 close.

PROFITS		REVENUES		ASSETS		MARKET CAP		EMPLOYEES
5.3 LION	No. 1	$92.6 BILLION	No. 14	$1.1 TRILLION	No. 2	$234.5 BILLION	No. 5	250,000

Data: Citigroup, Bloomberg Financial Markets

GONE BUT NOT GONE *"If I was a board member, I'd scratch my he and wonder if this really isn't just Sandy saying I'm going to give up, but really keep it . . . " says a top Wall Street lawyer.*

Street lawyer. "It's not typical to stay as chairman for three years after you leave. That suggests that he will exercise very substantial influence."

Weill's choice of Prince as his successor only inflamed suspicions that he intends to maintain control. Prince, 53, is known to be Weill's closest friend in the company. Weill recently hosted an engagement party for Prince and also took him and his fiancée—Margaret Wolff, a partner at New York law firm Skadden, Arps, Slate, Meagher & Flom LLP—on a Mediterranean cruise on his yacht. Prince, a lawyer who has worked for Weill since 1983, rose through the ranks starting as corporate counsel and all-round fixer, with unquestioned loyalty to the boss. What he noticeably lacks, however, is operating experience. By contrast, Willumstad, 57, is an accomplished financial-services operator who, despite his low-key demeanor, is a more independent-minded executive than Prince and periodically has found himself in Weill's doghouse because of it.

The question then is not only whether Weill will really let Prince be King, but whether Citi's next CEO has what it takes to follow in Sandy's outsize footsteps?

Prince is smart, articulate, polished, and capable of charming most anyone. "He's a good people person—a better people person than Sandy," says former Securities & Exchange Commission Chairman Arthur Levitt Jr., a partner of Weill's in his early days. But inside the bank, Prince, not unlike Weill, is known as a severe taskmaster who is bot mired and feared by underlings. "Hatchet man" is the acterization most favored by his critics.

By most accounts, Prince has acquitted himself well of his trouble-shooting assignments, particularly the highest-profile one: extricating Citi—and Weill—from and federal regulator's probes into conflicts of interest vestment banking. In April, Citi agreed to pay $400 m of a $1.4 billion settlement involving 10 investment b That was a larger penalty than any other firm paid. Prince appears to have made an unlikely admirer o New York State Attorney General Eliot Spitzer. "C Prince is a spectacular choice," Spitzer told *BusinessWee* spent more hours with him over the last year tha wanted or I expected. I have enormous respect for Chu his intellect and his integrity."

Even so, Prince was considered a dark horse to suc Weill because of his relative lack of operating experie For a brief six months last year, he ran Citigr emerging-markets operation, charged cleaning up after losses from one of th current financial crises in Argentina. one well-placed source: "He has not pr that he can deal with operations from bo up, lead the troops, or be strategic." A whether he plans to depart in any way Weill's approach as Prince replies: "I hope n

The House That Sandy Built

For more than forty years, Weill has cut deals—and cut a legendary swath—across Wall Street. Shut out at AmEx, he soldiered on to build the world's biggest financial behemoth through sheer force of will

1960 Forms brokerage firm. Future SEC Chairman Arthur Levitt becomes partner in 1968.

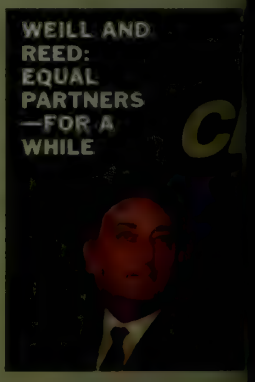
1981 Sells Shearson Loeb Rhoades to American Express for $930 million.

1984 With Weill as president, AmEx buys Lehman Bros.

1985 Quits AmEx after it becomes clear he will not succeed James Robinson as CEO.

1986 Takes control of Commercial Credit and becomes chairman and CEO.

1988-1997 Acquires Primerica, Travelers, and Salomon.



HANDS ACROSS THE STREET: ANNOUNCING TRAVELERS' $9 BILLION PURCHASE OF SALOMON BROTHERS

APRIL, 1998 Merges Travelers with Citicorp.

NOVEMBER, 1998 Weill's heir apparent Jamie Dimon, resign

OCTOBER, 1999 Former Treasury Secretary Robert Rubin joins Citi's office of the chairman.

't think you should look for dramatic changes from the agement team."

eam is the operative word here. Upon closer inspec-, Willumstad fares better under Weill's succession plan his COO title suggests. Citi's investment bank will con- e to report to Prince, as it has since last fall. But all of company's other major business units will report to umstad, who has run Citi's hugely profitable consumer- king business since December, 2000. Chief Financial Of- Todd S. Thomson will jointly report to Prince and umstad. "In all aspects pt officially, Bob Willum- appears to be the act- CEO, while Prince contin- to keep the wholesale stment bank on a short e," concludes David A. dler, an analyst at CreditSights research ice.

or his part, Weill told an- ts that he will do what- Prince and Willumstad him to do, but he would oy calling on government ials and enhancing our re- nships with different tries." However, Citi al- y employs Wall Street's ultimate door-opener—former asury Secretary Robert E. Rubin—in exactly this ca- y. Rubin joined Citi in late 1999 after leaving the Clin- Administration.

he stock market's immediate reaction to Citi's succession was skeptical. Citi shares closed at 45.52 on July 16, n 2.8%, compared with a 0.6% decline in the Standard & 's 500 financial index. "We view the announcement as a negative," says Michael Mayo, Prudential Financial's senior banking analyst. "A degree of the 'Sandy Weill premium' goes away." In addition, Mayo notes, "Prince is not well-known externally, and following in the footsteps of Sandy Weill is certainly not easy."

During the conference call, Weill's unscripted interactions with Prince and Willumstad unintentionally revealed just how tough adjusting to their new roles will be. At one point, Prince was musing about life after Sandy. "Not to have him come in and nag us and push us and drive us and demand excellence every morning, it is going to be a different world for us, but..."

Weill interrupted. "Why do you think I won't do that?"

"Every other morning, maybe?" Prince responded.

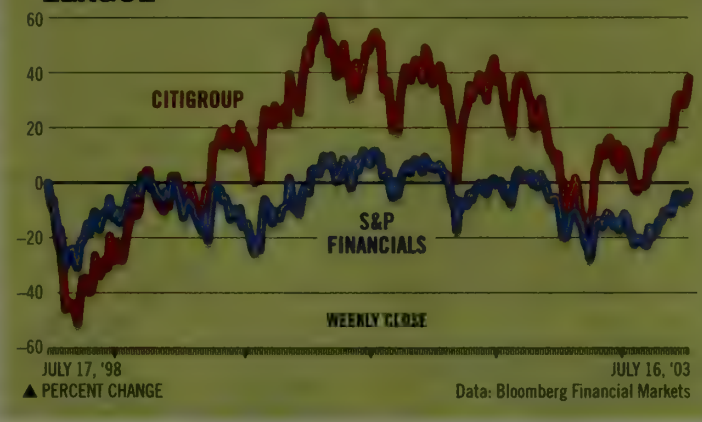
Weill also interrupted Willumstad as he was waxing on about management continuity. "So it is back to work tomorrow to keep doing what we've been doing," Willumstad said.

"I think it is really back to work today," Weill quipped.

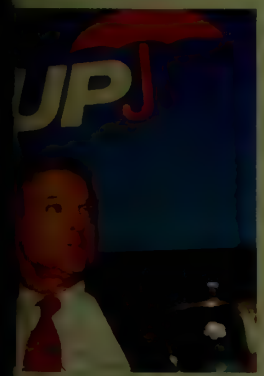
"Oh, excuse me," Willumstad said.

Weill's decision to step down as CEO doesn't seem to have been precipitated by an ultimatum from Citi's board or the special succession committee it set up last year. "The timing here was entirely Sandy," says Director Richard D. Parsons, chairman and CEO of AOL Time Warner Inc. Parsons, one of the committee's four members, says Weill announced three months ago that he was ready to set a schedule to shift authority to Prince and Willumstad. "I don't think it will be easy on Sandy personally," Parsons says. "But such is his regard for Chuck

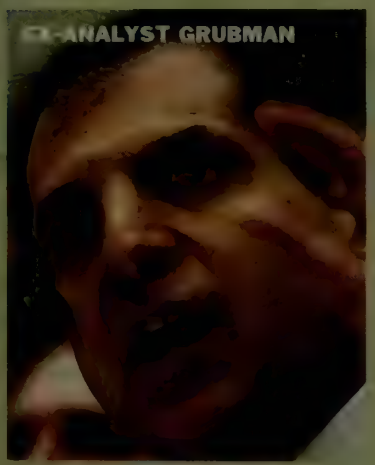
BEST OF LEAGUE *Citigroup has outpaced the S&P 500 Financial Index since it was formed by the merger of Travelers and Citicorp in 1998*



Data: Bloomberg Financial Markets



APRIL, 2000 Citicorp co-CEO John Reed leaves after losing power struggle with Weill.



JUNE, 2002 NASD and New York Attorney General Eliot Spitzer investigate star telecom analyst Jack Grubman.

OCTOBER, 2002 Appoints Sallie L. Krawcheck as head of Smith Barney brokerage and research.

APRIL, 2003 Citi agrees to pay $400 million as part of the $1.4 billion global settlement over stock-research practices.

JULY 15, 2003 Citigroup buys Sears' credit-card unit for $3 billion.

JULY 16, 2003 Weill says he will step down as CEO and COO by Jan. 1, 2004, but will remain chairman until 2006.

Chuck Prince

BORN

January 13, 1950, in Lynwood, California.

EDUCATION

Bachelor's degree in law and master's in international relations, University of Southern California. Master of Laws degree, Georgetown University.

NEW JOB

CEO of Citigroup by Jan. 1, 2004.

BONA FIDES

Weill's consigliere since 1986, advising on everything from billion-dollar deals to his exercise regimen. As head of Citi's troubled investment bank since last summer, Prince played a key role in settling regulatory probes and revamping operations.

M.O.

Charming but tough.

AFTER HOURS

Guns his power boat, listens to classical music, and is now helping to plan his wedding.

FAMILY

Engaged to Margaret Wolff, Skadden Arps M&A partner; two adult children from first marriage.

and Bob that I believe he will do what he has to do to make it work."

Yet Weill did not so much as mention his plan to Prince Alwaleed bin Talal, Citi's largest shareholder, when he had a tête-à-tête with him in Paris just five weeks ago. "I was looking at something like this in about a year's time," says Alwaleed, who owns about 200 million shares of the bank and has been an unflagging Weill supporter.

Throughout his career, which began in the 1950s as a Wall Street runner, Weill has displayed an impeccable sense of timing. By the time he approached Parsons and other directors, glimpses of blue sky were breaking through the storm clouds that had obscured Citi's future since early 2002. The hard-earned settlement with Spitzer and the SEC was in hand and, equally important to Weill, the fundamentals of Citi's business were strengthening virtually across the board.

On July 14, Citi announced its best quarterly results ever. Earnings from continuing operations hit $4.3 billion, up 14% from a year ago, on an 8% gain in revenue, to $19.4 billion. Citi's net income of 83¢ per share beat the Street's consensus estimates by 3¢. Just three hours after it released earnings, Citi gilded the lily by announcing a huge 75% increase in its quarterly dividend, to 35¢, thereby increasing its payout ratio to 42% from 24%. In a lackluster market, Citi's stock spiked by nearly $1 a share to close at $47.13.

"I don't think it's a coincidence that they raised the dividend 75%," says Samuel L. Hayes III, professor of investment banking at Harvard Business School. "He wants to go out with a bang, and this does it in terms of a very tangible signal that goes out to the shareholders of Citigroup." Adds Prince Alwaleed: "This is Sandy looking after his legacy and very deservedly so. And he's telling the market that he is very confident about the future of Citi, otherwise ther way he would implement the dividend incre

As a large Citi shareholder, Weill also reaped a hu nancial benefit to cushion his eventual retirement, wh er that comes. The annual income on his 22 million s now totals $31.4 million, up from $17.9 million.

Sandwiched tightly between the dividend hike an succession plan came the news of Citi's purchase of credit-card operation. While some analysts are skepti this acquisition—many of Sears' existing accounts are bled and delinquent—most are eagerly anticipating b and better deals to come. "They're getting the M&A ma going," says Anton Schutz, portfolio manager of the million Burnham Financial Services Fund, which 140,000 Citi shares.

CFO Thomson says that Citi is looking to make ac tions not only in credit cards, but in private banking, management, back-office transaction services, and banking, especially sizable regional banks. Speculati rife that the likes of FleetBoston Financial Corp. and Commerce Bank, a division of J.P. Morgan Chase, are a top of Citi's buy list. Given Citi's enormous size—it $1.1 trillion in assets—these sorts of deals would only ac crementally to its growth. "The transforming deal longer what this company needs," says Thomson.

That may be. But Weill should never be underestim No doubt, he would like nothing better to retire—whe er he really does retire—in the afterglow of yet anc colossal acquisition.

By Anthony Bianco, with Emily Thornton, Mara Hovanesian, David Henry, and Mike France in New John Rossant in Washington; and bureau reports

Bob Willumstad

BORN

Aug. 22, 1945, in Bay Ridge, Brooklyn.

EDUCATION

Attended several colleges in New York but never earned a degree.

NEW JOB

COO of Citigroup by Jan. 1, 2004.

BONA FIDES

Has worked for Weill for the past 17 years. Though he has been president since January, 2002, it was Willumstad's other job, running the Global Consumer Group, that won him the most recognition: The group accounted for 60% of Citi's total earnings this past year.

M.O.

Quiet but forceful.

AFTER HOURS

Listens to Elvis Presley (and wore an Elvis outfit his 55th birthday party).

FAMILY

Married to Carol, who once ran an ice-cream ar chocolate shop on Long Island; they have two adult daughters.

(TOP TO BOTTOM) PHOTOGRAPHS BY MALCOLM LINTON/BLOOMBERG NEWS, STEVEN HIRSCH/CORBIS SYGMA

By Louis Lavelle

THE PROBLEM OF THE 'LINGERING CEO'

As regime changes go, the resignation of Sanford I. Weill as chief executive of Citigroup Inc. was deeply unsatisfying. Instead of abdicating his role as chairman when he steps aside in January, Weill, 70, will remain in that position until 2006. That leaves the new CEO, Charles O. "Chuck" Prince III, in a power-sharing arrangement with one of the most towering figures in Corporate America. By having Weill stay on as chairman, Weill and the Citigroup board have committed a cardinal sin of corporate governance—creating an ambiguous chain of command. Says Nell Minow, editor of the Corporate Library, a governance Web site: "What you have now is a CEO who is neither gone nor forgotten."

As a rule, separating the roles of CEO and chairman is something governance experts applaud. But filling the chairman's position with a "lingering CEO" presents a host of problems. The new CEO may be undermined by the old, who is now in a perfect position to second-guess the new chief's strategy and direction. The board will often remain loyal to the old CEO—who may have built up decades of goodwill among directors. And particularly if the old CEO makes it clear that he intends to remain active, as Weill has done, it creates two power centers in the company, hobbling management. Ideally, governance experts say, outgoing CEOs should toss the new chief the keys—as Jack Welch did with his successor at General Electric Co., Jeffrey R. Immelt—and not look back.

For a cautionary tale on the dangers of power-sharing arrangements, Citi need look no further than its own recent history. In 1998, when Weill merged Travelers Group Inc. into Citicorp, he became co-CEO with John S. Reed, resulting in a distracting power struggle that ended two years later with Reed's departure. If that's not enough, the Citi board should consider Xerox Corp. After G. Richard Thoman was named CEO in 1999, his predecessor, Paul A. Allaire, remained as chairman, undermining Thoman's authority at every turn and ultimately ousting him as CEO in 2000. At Dow Chemical, Newell Rubbermaid, Maytag, and elsewhere, former CEOs who have remained on the board have replaced their handpicked successors after they encountered problems.

The reason many companies keep their former CEOs on as chairmen is simple. Leaders like Weill, who have held the reins for many years, have a deep understanding of the company that boards are loath to give up. Keeping the former CEO as chairman ensures the new chief has a sounding board with a reservoir of institutional knowledge. During the transition to a new leader—even one who's been around for nearly two decades, as Prince has—this can be invaluable.

But in Citi's case, the board had many options. Its deep bench of management talent and largely independent board provide a number of candidates for chairman. Even Citi insider Robert E. Rubin, the former Treasury Secretary and Goldman, Sachs & Co. co-chairman who joined Citi four years ago as a top adviser, would have been a better choice. He has much of the board experience and none of the baggage. Or Citi simply could have given Prince both titles, and appointed a lead director to preside over meetings of the board's outside directors, as Tyco International Ltd. and Walt Disney Co. have done. Another alternative: The directors could have kept Weill as chairman for a six-month transition period, as many companies do, and then given him a contract to advise the new CEO.

True, for some directors and investors, the idea of keeping Weill on board for the next three years is a comfort, particularly as Prince is light on operating experience. After all, Weill built Citi into the world's biggest financial-services company, with $1.1 trillion in assets—and he is the operational genius who has delivered a 26% average annual return since forming Citigroup in 1998. Former Securities & Exchange Commission Chairman Arthur Levitt Jr., who worked with Weill for 13 years at the brokerage firm Cogan, Berlind, Weill & Levitt, says Weill's continued presence should reassure Citi shareholders. Says Levitt: "Many of the talents he had to bring to bear are still going to be there, and his influence will continue to be felt."

Weill is a great leader–but his continued presence will only cramp Prince's style

But that, experts say, is exactly the problem: His influence will continue to be felt. Prince already has a tough job ahead of him if he's to keep Citi growing. Having Weill peering over his shoulder won't make it any easier. If Weill wants what's best for Citi—and he should, given his $1 billion stake in the company—he shouldn't wait. He should cut the cord now.

Lavelle covers management from New York.

COMPENSATION

BEYOND OPTIONS

However you slice it, the new mix will cost companies mo

Every few months, compensation consultant Paula Todd meets with a group of clients from large corporations in the Stamford (Conn.) offices of Towers Perrin. Generally they cover a variety of topics, but on Tuesday, July 15, a week after Microsoft Corp. announced it would halt issuing stock options in favor of more traditional restricted shares, they were still fixated on the move. "Microsoft is a powerful company with a lot of influence," says Todd. "There is a powerful knee-jerk reaction to follow them."

To follow Microsoft or not. To rein in the use of stock options or not. That's a decision companies across the economic landscape, small and large, high tech and nontech, are heatedly debating. Over 50% of all corporate stock options are currently underwater—i.e., their strike prices are higher than the price the underlying shares are trading for. That has decimated their usefulness as a tool to retain and motivate employees. At the same time, in reaction to the freewheeling 1990s, there is a growing push to account for options as an expense. And shareholders, still stung by the options-fueled stock packages that made multimillionaires of managers at scandal-rocked companies such as Tyco International, Global Crossing, and Enron, are also up in arms.

Put it all together, and there's plenty of impetus for reconsidering the dominant pay incentive of the 1990s. "Options were a very long fad. They had a very long run," says Ford Motor Co. Vice-Chairman Allan Gilmour. "This is the time to rethink how this works going forward." Even many tech companies recognize that options need to be limited. "If you look at high-technology companies, the use of stock options—it got to be like the nuclear arms race," says Dell Computer Corp. founder and CEO Michael S. Dell. "And it just didn't make sense."

It's a very different picture from the go-go bull market days, when options were handed out like candy. Behind that craze was the conviction at many companies that options were essentially free. Although they dilute shareholders' equity when they're exercised, taking the cost of stock options as an expense against earnings has not been required. That helped keep earnings plump. If options had been expensed in 2002, for example, 23% of the S&P 500's earnings would have been erased. "It was a free resource, and because of that, it was used freely," says Bank One Corp. CEO James Dimon, who has voluntarily begun expensing options. "But now, when you have to expense it, you start to think: 'Is it an effective cost? Is the better way?'"

A BIG HIT TO EARNINGS

If options had been expensed, earnings would have been whacked as their popularity grew

OPTIONS EXPENSE AS A PERCENT OF NET EARNINGS FOR S&P 500 COMPANIES

1996	1998	2000	2002
2%	5%	8%	23%

Data: *The Analyst's Accounting Observer*, R.G. Associates Inc.

If options seemed for a time to magic bullet that enriched CEOs, emp ees, and investors alike, what's con next will likely be less volatile, poss less remunerative, and more comp Pay will increasingly consist of a mi options, restricted shares, and bonuses. And whatever form new c pensation perks take, they're likely be more closely tied to achieving spe- cific operating goals. If options are expensed, companies face "a lot of hard choices," says Blair Jones, an executive-compensation expert at Sibson Consulting.

Moreover, it's not just employees who are looking for a new route to riches after several years of poor stock performance. Invest no longer able to count on capital ga are also demanding more secure turns. That, in combination with reduction in dividend taxes, is for more companies to consider upp their dividends. On July 14, Citigr hiked its meager dividend 75%, by billion annually—a move many com nies are expected to imitate.

The combination means increa financial pressure on companies. only will they have to come up w more cash to reward shareholders, those dividend paying companies switch to restricted stock will also them to employees from the date the grant. That adds up to more mands on corporate cash—and less

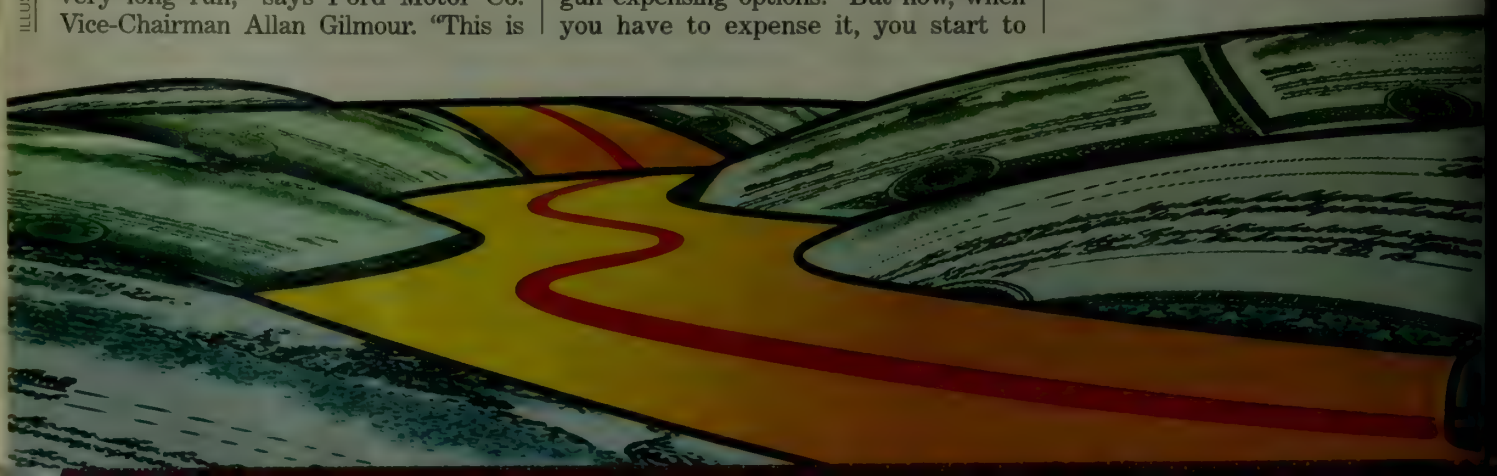


ILLUSTRATION BY DOUG FRASER, DIGITAL IMAGING BY DAVID RUDES/BW

ouse to invest in future growth. ill, going the Microsoft route is nei- possible nor preferable for every any. Since the software giant has dy decided to expense options, it's y to save north of $500 million a in compensation by replacing stock ns with more modest amounts of icted shares. But not every company med with a cash hoard of $50 billion plenty of shares to give away in restricted grants. Given its strong earnings history, Microsoft is also in a better position than many others to move toward a form of stock compensation that will take a chunk out of the bottom line.

Late to The Party

As many technology companies have downsized their options programs, old-line companies have been beefing theirs up

	2002 OPTIONS GRANT MILLIONS	CHANGE IN SHARES FROM 2001		2002 OPTIONS GRANT MILLIONS	CHANGE IN SHARES FROM 2001
LUCENT	14	–96%	CONOCO PHILIPS	29	+600%
SIEBEL SYSTEMS	6	–95	SYSCO	31	+560
APPLIED MATERIALS	9	–91	SOUTHWEST AIRLINES	53	+435
MICROSOFT	41	–82	SAFECO	3	+326
AOL TIME WARNER	115	–41	CAMPBELL SOUP	15	+301

Data: *The Analyst's Accounting Observer*, R.G. Associates Inc.

Yet there's little question that Microsoft's thunderbolt means executives and boards of directors throughout Corporate America will have to engage in an increasingly public debate over what to do. In response to a story in the *Financial Times* about board disagreement over expensing options, Sun Microsystems Inc. issued a statement asserting its commitment to them. At chip-equipment maker Applied Materials Inc., CEO Michael R. Splinter spoke up for options after his CFO publically called Microsoft's decision to issue restricted stock a bold move that could provide a blueprint for other companies.

Elsewhere, the impact is being debated down the line. Earlier this year, for instance, Dell CFO James M. Schneider sat down with managers of each of the computer maker's business units. He forced them to factor their planned options awards into their individual profit-and-loss projections as if the company were already expensing them. The dramatic effect: This year, Dell will dole out roughly 40 million options—less than half the 84 million it gave out last year and about a quarter the number it granted in 2000. There is no plan to make up the difference for the rank and file, though Dell added a long-term cash-bonus plan for a handful of top executives.

The danger, of course, is that the pendulum could swing too far the other way. Options may have been overused in the boom, but evidence suggests that smart use of options and other compensation do boost performance. Companies that spread ownership throughout a large portion of their workforce, through any form—options, Employee Stock Ownership Plans, or other means—deliver total shareholder returns that are two percentage points higher than at similar companies, according to a review of three decades of academic studies in *The Truth About Stock Options*, a book on the topic by Joseph Blasi and Douglas Kruse, professors at Rutgers University, and *BusinessWeek* Senior Writer Aaron Bernstein.

Better stock performance isn't the only benefit. Companies with significant employee ownership do better on a wide range of performance metrics, including productivity, profit margins, and return on equity, according to the studies. By giving restricted stock broadly, Microsoft showed it's still a believer in equity culture. "What Microsoft didn't do when they switched from options to stock is to cut back on who gets equity," says Corey Rosen, executive director of the National Center for Employee Ownership in Oakland, Calif. "They just changed its form."

For companies looking to emulate the huge success of Microsoft over the past 20 years, that's a point well worth taking to heart.

By Nanette Byrnes in New York, with Andrew Park in Dallas, Joseph Weber in Chicago, David Welch in Detroit, and bureau reports

COMMENTARY

By Steve Hamm

EXPENSE OPTIONS—BUT GIVE STARTUPS A BREAK

These days it's hard to picture Microsoft Corp. as a pint-size upstart, but back in 1985, the year before it went public, its fiscal-year revenues were just $140 million—with a $24 million net profit. Yet Microsoft's initial public offering turned on the ignition for what became one of the world's largest wealth-creation machines. A share bought at the offering price of $21 would be worth $7,776 today and double that at its peak. At the time, Microsoft employees held 2.5 million stock options. As the share price soared, options attracted the best and brightest from giants such as IBM and Digital Equipment Corp. and helped Microsoft retain its most valuable employees.

If stock options had been treated as expenses at the time, would Microsoft have had a harder time taking off? Possibly. "Microsoft's history is proof that early-stage companies need broad-based stock options," says Joseph Blasi, an economics professor at Rutgers University and co-author of *In the Company of Owners: The Truth About Stock Options*. "They could not have afforded to offer that kind of employee ownership if stock options were expensed."

Options helped build the tech industry into a powerhouse in the 1980s and fueled America's productivity engine during the '90s. Mandatory expensing of options could make it harder to get that machine humming again—with a negative impact on both competitiveness and productivity.

Large companies can afford to expense options, but startups could find it harder to bring new innovations to market. Expensing would make it more difficult for startups to recruit, since they use the potential of a huge options payday to lure top talent. It could suppress earnings at a time when startups need credibility with potential customers. Analyst's Accounting Observer estimates that expensing would have suppressed the earnings of the Standard & Poor's 500 by 23% in 2002. The impact on options-heavy startups could be considerably higher. Expensing could also delay their IPOs since post-boom, investors want to see a strong earnings track record.

That's why a case can be made for giving pre-IPO companies a break on stock options. The Financial Accounting Standards Board appears to be open-minded about the matter. While FASB is poised to make expensing of stock options mandatory, its chairman, Robert H. Herz, agrees that startups are different. "Pre-IPO, non-public companies are one of the issues we need to address as to whether or not there should be something different in how you account for those companies' stock compensation," he says.

Making exceptions for startups doesn't sound fair to critics of the way stock options have been handled. They think there should be one standard whether a company is public or private. But government rules are full of exceptions—the graduated income tax, for one. Already, FASB stock-option regs make exceptions for some categories of companies. Non-public companies that expense options get to calculate their valuations using a different formula than the rest.

An accommodation for startups need not be limited to FASB's rulebook. Congress could make exceptions, too. Rutgers prof Blasi is considering the notion that legislators could provide a tax break equal to the option expenses for companies that offer options to most of their employees. His research shows that companies with broad-based equity outperform those that do not.

It shouldn't be difficult to fashion a stock-option deal for pre-IPO startups that's fair to companies, employees and investors. But time is running out. FASB plans to issue a recommendation by yearend. Microsoft may not need stock options anymore but all the potential Microsofts out there could sure use a helping hand.

Senior Writer Hamm writes about technology from New York.

WAY BACK WHEN: *Bill Gates and Paul Allen in 1984*

HOW EXPENSING COULD HURT

RECRUITING Young tech companies have long depended on options to lure talent. Expensing will likely reduce grants, meaning they'll have to rely more on cash compensation.

PROFITS It will have a disproportionate effect on the net income of startups, since they rely heavily on options for compensation. That will suppress profits at a time when startups are attempting to gain credibility.

GOING PUBLIC As the IPO market perks up, companies will need to demonstrate profitability before they can go public. Entrepreneurs worry that expensing could delay their IPOs by up to a year.

COMMENTARY

By Amy Borrus and Mike McNamee

STATES VS. THE SEC: WHAT'S ALL THE SHOUTING FOR?

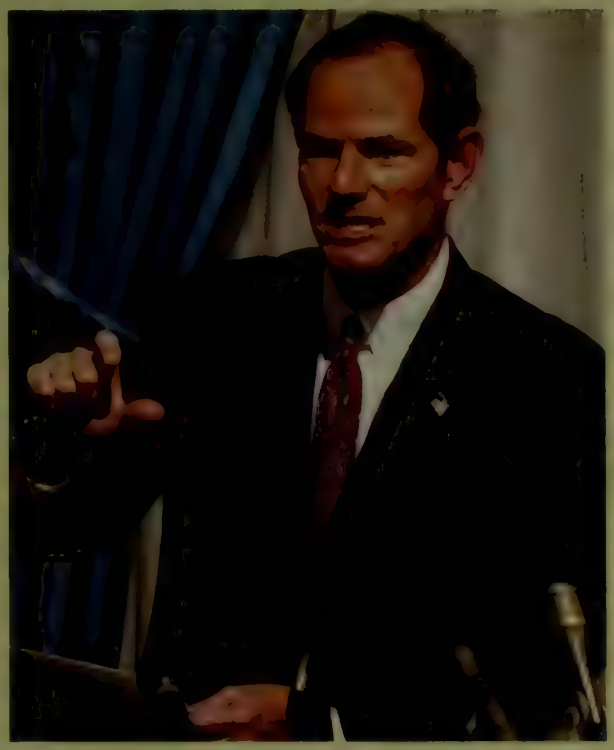
On the surface, it looks like the fragile alliance between state and federal securities cops is crumbling. On July 14, New York State Attorney General Eliot Spitzer challenged Securities & Exchange Commission Chairman William H. Donaldson to oppose a bill in Congress that would curb states' power to police brokerages. Donaldson testily replied that setting rules for markets "is the prerogative of the SEC."

There's more—and less—going on here than meets the eye. Yes, Donaldson and Spitzer disagree over states' power to shape rules for Wall Street. But the states and the feds are still working cooperatively. What's brought the SEC chief and Spitzer to swords' point is a clumsy attempt by an influential lawmaker to rein in states' power—and to embarrass states over their use of fines from securities-fraud settlements.

House capital markets subcommittee Chairman Richard H. Baker (R-La.) triggered the flap on July 10, when his panel passed a bill to beef up the SEC's enforcement powers. At the last minute, Baker inserted a provision saying state enforcers can't impose tougher rules on brokerage firms than the SEC's. It's a sound principle: U.S. securities markets should operate under national rules, a dictum endorsed by Federal Reserve Chairman Alan Greenspan. "The argument that you have national markets and you should have a single regulator is the correct position," the Fed chief told the Senate Banking Committee on July 16.

But Baker's attempt to write that idea into law is doing far more harm than good. State securities cops, along with experts like Columbia University law professor John C. Coffee Jr., say Baker's bill would weaken investigations by barring them from ordering reforms—like the analyst overhaul that Spitzer won from Merrill Lynch & Co. Says Spitzer: "Defense lawyers will use this in every way they can to prevent us from investigating fraud."

ALLIES? Baker, Donaldson



A congressional bill that aims to beef up SEC enforcement power while curbing the states' is sparking a turf fight between the two

SPITZER'S INQUIRY INTO MORGAN STANLEY ANGERED THE SEC

Washington is in no position to throw its weight around. The SEC is still living down its reputation, earned under Harvey L. Pitt, for being slow to combat Wall Street's abuses. And state enforcers are widely seen as champions of the little guy—none more so than Spitzer. "This is not the right time to take on the states," says one SEC insider.

The SEC is caught in the middle. It wants the bill's useful new tools for pursuing miscreants—an override of state bankruptcy rules, for example, that let fraudsters buy megamansions in Florida or Texas to shield unlimited wealth. But Baker's insistence on reining in the states is diminishing the bill's already slim chance of passing.

SEC officials aren't too pleased with Spitzer, either. He's trying to embarrass the SEC by taking on a case—complaints against Morgan Stanley over mutual-fund sales practices—that the SEC has been investigating vigorously for months. Spitzer allies claim the SEC sat on allegations of wrongdoing by Morgan Stanley for years before launching its probe in January. SEC officials say Spitzer is dredging up dirt from the Pitt era.

Then there's the money. Baker first tried to order states to turn over penalties to an SEC-run restitution fund for injured shareholders. That didn't fly, but his latest measure puts a spotlight on states that don't repay investors. While some states have used their share of the analyst settlement to bolster investor protection, others pour the funds into such purposes as building motor vehicle license branches. "I guess if they catch a securities violator they'll take away his driver's license," Baker quipped on CNBC. Forget about states' rights, says one financial lobbyist: "It's all about the money."

That's probably too cynical. Serious issues are at stake. The states must be able to step up enforcement when the SEC is complacent. But the system works best when securities cops from Washington and the state capitals pull together. Under Donaldson, such cooperation was beginning to bloom. Both Baker and Spitzer are acting to protect turf—when they ought to be more concerned about protecting investors.

With Mike France in New York

COMMENTARY

By Rich Miller

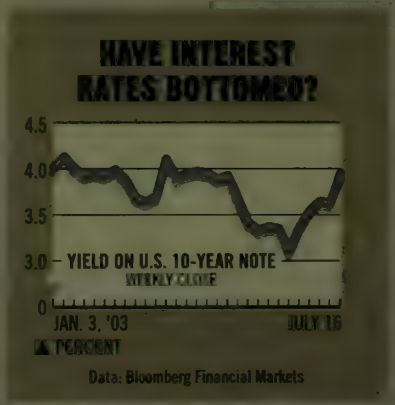
THE FED CAN'T AFFORD A BOND MARKET WITHOUT FAITH

What we have here is a failure to communicate. The bond market has been on a roller-coaster ride recently as investors struggled to divine the intentions of the Federal Reserve. Gambling that the Fed would buy bonds to help ward off deflation, investors piled into the market in mid-June, sending the yield on the 10-year Treasury note to a 45-year low of 3.1%. But when the Fed opted to merely trim interest rates on June 25, investors turned tail and sold.

The *coup de grâce* came on July 15 as Chairman Alan Greenspan forecast faster economic growth and seemingly all but ruled out bond purchases by the Fed. The market quickly tanked. Greenspan tried to turn the tide the next day by saying he hadn't taken bond buys off the table. The damage had been done, though, and the 10-year yield ended the day at close to 4%.

The wild market fluctuations have left a sour taste in the mouth of many a market participant. Some mutter about being manipulated and misled by the Fed. "Greenspan has lost some credibility with the market," says Melvyn B. Krauss, senior fellow at Stanford University's Hoover Institution.

Of course, some of the rise in bond yields is due to growing hopes for an economic rebound—a phenomenon to be welcomed. Yet the rapid increase in long-term interest rates also reflects wariness about the Fed, and that's far more worrisome. If investors feel they can't count on a predictable Fed, they're apt to push bond yields and long-term rates up higher than justified by the strengthening economy alone. A premium for Fed risk could even lift rates to the point where they hurt the very economic recovery the market is anticipating. "This is not an economy that's going to take off like a rocket," says former Fed Governor Lyle Gramley, now senior economic adviser for Schwab Capital Markets LP. "I would be more comfortable if 10-year yields were at 3½%, instead of 4%."



Such a reversal isn't likely anytime soon. The federal budget deficit is ballooning. The White House on July 15 predicted a financing shortfall of $455 billion in fiscal 2003, and $475 billion for fiscal 2004. The forecast fanned fears in the bond mark of stepped-up sales of Treasury securities, helping to send prices even lower.

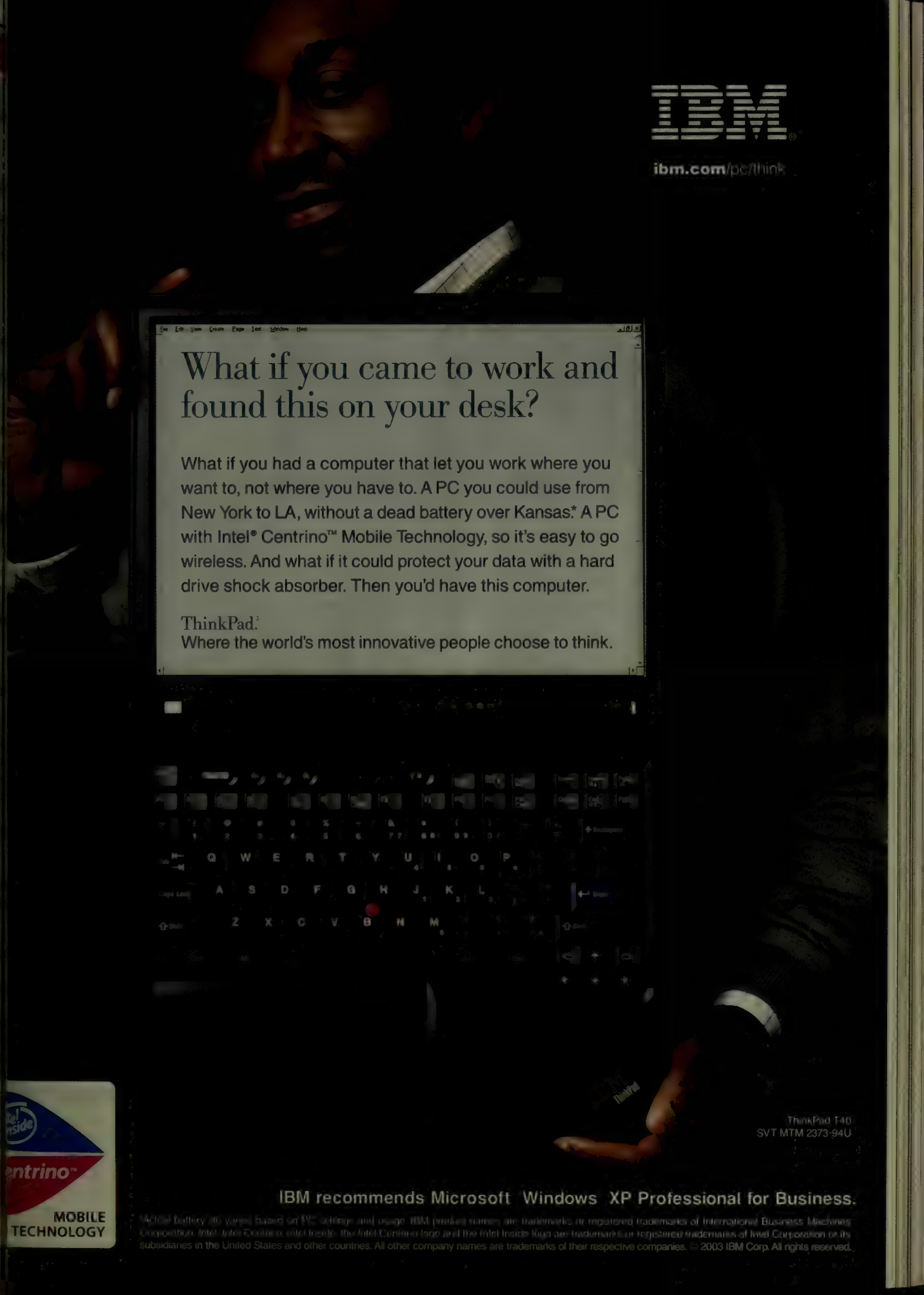
What's more, dealers, banks, and hedge funds are sitting on large bond positions they built up via so called carry trades—borrowing mo ey at low short-term rates and the investing it in longer-dated securities. But with the value of those bond investments falling, there's a risk of a major sell-off as those trades are unwound, says economis Henry Kaufman.

Who's to blame for the breakdow in communication, bond traders or the Fed? The answer: a bit of both Fed policymakers egged on investo in June with warnings about the dangers of falling prices, capped off by Greenspan's colorful comments o the need to build a "firebreak" against deflation. In private meetin and public speeches, Fed officials suggested they were deliberately trying to guide long-term rates low and left open the possibility of buying bonds to help their chances. "I don't think the market was complet ly on drugs," says Citigroup economist Robert V. DiClemente.

There's no doubt that investors read more into some comments tha the Fed intended. They ignored repeated warnings by Greenspan and other Fed policymakers that the ris of deflation was, after all, remote. I stead, they snapped up bonds in the mistaken belief that a desperate Fe would bail them out by buying up their securities. "The market has go to take some responsibility for its own actions," says former Fed Governo Laurence H. Meyer.

Whoever is at fault, the markets' eroding confidence i the Fed has consequences. The danger grows if investors feel so threatened b what they see as an unsteady Fed policy that they demand ever higher risk pre miums on Treasury bonds. It hasn't happened yet. If Greenspan & Co. aren't careful, however, they could b in for another month like the last—and the economy will be the loser.

Miller covers the Fed in Washingto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ThinkPad.
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ThinkPad T40
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IBM recommends Microsoft Windows XP Professional for Business.
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MOBILE TECHNOLOGY

TELECOM

MOTOROLA: 'A SHOT OF ADRENALINE'

Will a slew of new phones put an end to its slump?

When Motorola announced disappointing sales on July 15, execs were right to blame forces outside the company's control—tough times in China, due to SARS and inventory buildup. Those factors helped push sales down 10% for the quarter ended in June, to $6.2 billion. And they partly explain why phone sales, which account for nearly 40% of the company's revenues, fell 13%, to $2.3 billion.

But dig a little deeper and there's much more to the Schaumburg (Ill.) company's woes than SARS and Asia's oversupply. At the top of the list: a dearth of new phone models. So far this year, Motorola has released just six phone models worldwide. Meanwhile, market leader Nokia Corp. has shipped 13 new handsets, and hard-charging No. 3 phonemaker, Samsung Group, plans scores of releases. Many of their new phones sport such hot-selling features as cameras and color screens. With fewer new products of its own, say analysts, Motorola has almost certainly lost market share.

To address that, CEO Christopher Galvin told analysts July 15 that innovation will become a top priority. Over the next six months, Motorola will inundate the market with no fewer than 31 new handsets. If the phones are a hit, it will be a testament to Galvin's and COO Mike Zafirovski's efforts to move the company from a tradition of emphasizing technology over applications consumers want. The new phone models, says Wojtek Uzdelewicz, a wireless equipment analyst for Bear, Stearns & Co. will give Motorola "a shot of adrenaline." But, he adds, "it's not one quarter that makes a company."

Besides, Motorola will be playing catch-up. A year ago, Nokia and Samsung already were building phones with the latest multimedia applications, but Motorola held back. "The [camera] capability is still maturing," Steve Lalla, director of global product marketing for Motorola's phone unit, said in January. "It's a bit early." As a result, Samsung and Nokia beat Motorola to market with a range of sought-after phones that boast color screens and snap digital photos.

That means Motorola will be entering niches where Samsung and Nokia already have a strong foothold. Motorola's first integrated camera-phone arrives in Europe in the fall—and won't debut in the U.S. until even later. There's plenty of potential growth at stake. Globally, camera-phone sales are expected to dou 16% of the industry total in 2004. growth likely will be even more rob Europe, the world's biggest cellula ket. Motorola is feverishly trying

CEO GALVIN
His company is late to the camera-phone party

better in Europe, its share fell to 6 quarter, down tw centage points in a says researcher G Inc. "Motorola d get to have the l moon period wher can build volume," says Sanford C. stein & Co. analyst Paul Sagawa stead, they'll be thrown into a competitive market."

Motorola also faces daunting new lenges in its strongholds. It lead U.S. market, with a 32% share, and nearly that much of China's fast-ing market. But Nokia is fighting hard in both places. After neglecti technology favored by Verizon Wi and Sprint PCS, the Finnish giant veiling several new phones for thos riers this year. "Nokia is not abo concede the world's No. 2 market," Deutsche Bank analyst Brian T. M

It certainly has the wherewith fend off Motorola. Top-flight manuf ing and design enable it to introduc 10 new phones every quarter— faster than the 9 to 12 months Mo historically has taken to roll out products. Why the huge difference? builds most of its phones around a mon chipset—the smart innards phone—allowing it to snap on diff features and designs. Motorola has gled to implement similar technology now, the company is finally standar phones around a common core yearend, says Zafirovski, 70% of M la's new phones will sport the ne sides, which should speed its launch

By yearend, Zafirovski told ana Motorola will return to growth. The important step to getting there, he cedes, is improving new product duction. Motorola has made these p ises before. This time, it must deliv

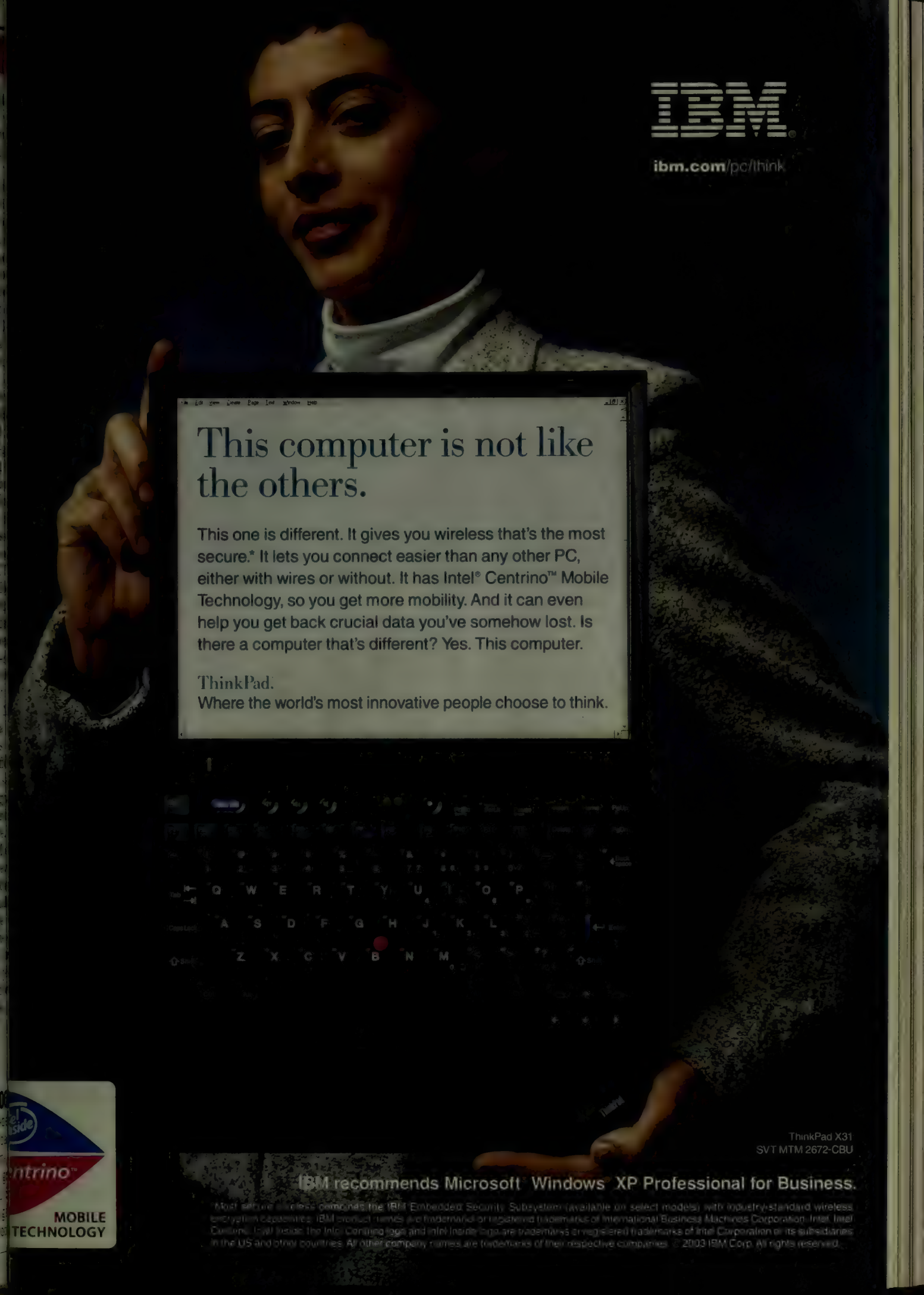
By Roger O. Crockett in Chicago, Andy Reinhardt in Paris

PLAYING CATCH-UP

MOTOROLA T720i
The $250 flip phone with camera attachment is big in the U.S. But it can't compete in Europe, where Nokia and Samsung phones sport color screens and embedded cameras.

NOKIA 3650
This $300 camera phone hit the U.S. in February—seven months ahead of Motorola's expected entry. A slew of new U.S. models could put Nokia further ahead.

SAMSUNG A60
With its soon-to-b released $350 ca era phone, Sam-sung hopes to g share in the U. and Asia and g traction in Euro


IBM
ibm.com/pc/think
This computer is not like the others.
This one is different. It gives you wireless that's the most secure.* It lets you connect easier than any other PC, either with wires or without. It has Intel® Centrino™ Mobile Technology, so you get more mobility. And it can even help you get back crucial data you've somehow lost. Is there a computer that's different? Yes. This computer.
ThinkPad.
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ThinkPad X31
SVT MTM 2672-CBU
IBM recommends Microsoft® Windows® XP Professional for Business.
MOBILE TECHNOLOGY

RETAILING

IS KOHL'S COMING UNBUTTONED?

Slovenly stores and shrewd competition have hurt sales

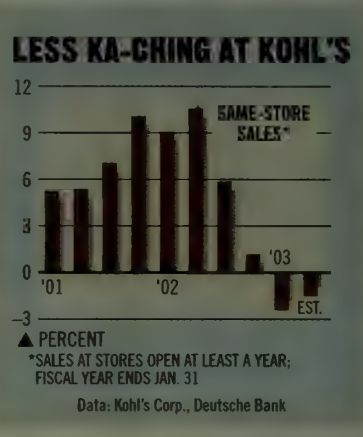
Shopping recently at a Kohl's store in Niles, Ill., Kimberly Rellinger can't find any boys' shorts as she digs through a jumble of misplaced items. And she gives up on the shorts idea altogether when she sees the five-person checkout line. Instead, she heads to a nearby Old Navy, where she finds what she wants with no wait. "Now I will go there first," says the 36-year-old mother of two boys.

Plenty of Kohl's shoppers seem to be making the same call these days. On July 10, the apparel discounter reported a 2.4% decline in June sales at stores open at least a year. Worse, it warned that for the first time since going public in 1992, second-quarter earnings would decline. In part, the disappointing numbers reflect growing competition from department and specialty-apparel stores. But Kohl's Corp. execs may also have lost their Midas touch: Distracted by a big expansion into California, they have misjudged inventories and relaxed once-tight control of existing operations.

It's quite a reversal for this '90s retail star. Until recently, it seemed the Menomonee Falls (Wis.) chain could do no wrong. Kohl's has posted 35% compounded annual earnings growth over the past five years. It did so with the simplest of strategies: selling casual brands at low prices. By locating its stores in strip centers, Kohl's draws shoppers who find malls inconvenient. Now, having missed sales targets for 7 of the past 9 months, Kohl's heady days may be over. "It's the first crack in the growth story," says Deutsche Bank Securities Inc. analyst Bill Dreher.

Nonsense, says Kohl's CEO R. Lawrence Montgomery. He attributes the weak sales to a sluggish market for apparel, which affects Kohl's more than department-store rivals because clothing makes up a higher percentage of its sales. But, he admits, the competition has "narrowed a little bit."

Indeed, rivals ranging from J.C. Penney and Sears, Roebuck to Federated Department Stores' Macy's unit have borrowed from Kohl's playbook. Like Kohl's, they made their stores easier to navigate and beefed up casual brands. Most of all, they have cut prices to counter the advantage of Kohl's locations, says Marshall Cohen, chief analyst at market-research firm NPD Group Inc. As a result, Penney, Sears, and Federated all posted better sales results than Kohl's in June. "The consumer is going back to the mall because they can get a better price with a wider variety," Cohen says.



Department stores aren't the only ones playing better defense. Gap Inc.'s Old Navy unit, whose shops are often based in strip centers with Kohl's, has recently shifted from trendy teenage fashion toward clothing that appeals to mothers with children, one of Kohl's targets. On the low end, Kohl's is facing more pressure from Wal-Mart Stores Inc., which is upping the quality of its apparel and adding national brands like Levi's. "Wal-Mart is also after the middle-level shopper," says Patri Keever, an analyst at SunTrust son Humphrey Capital Markets.

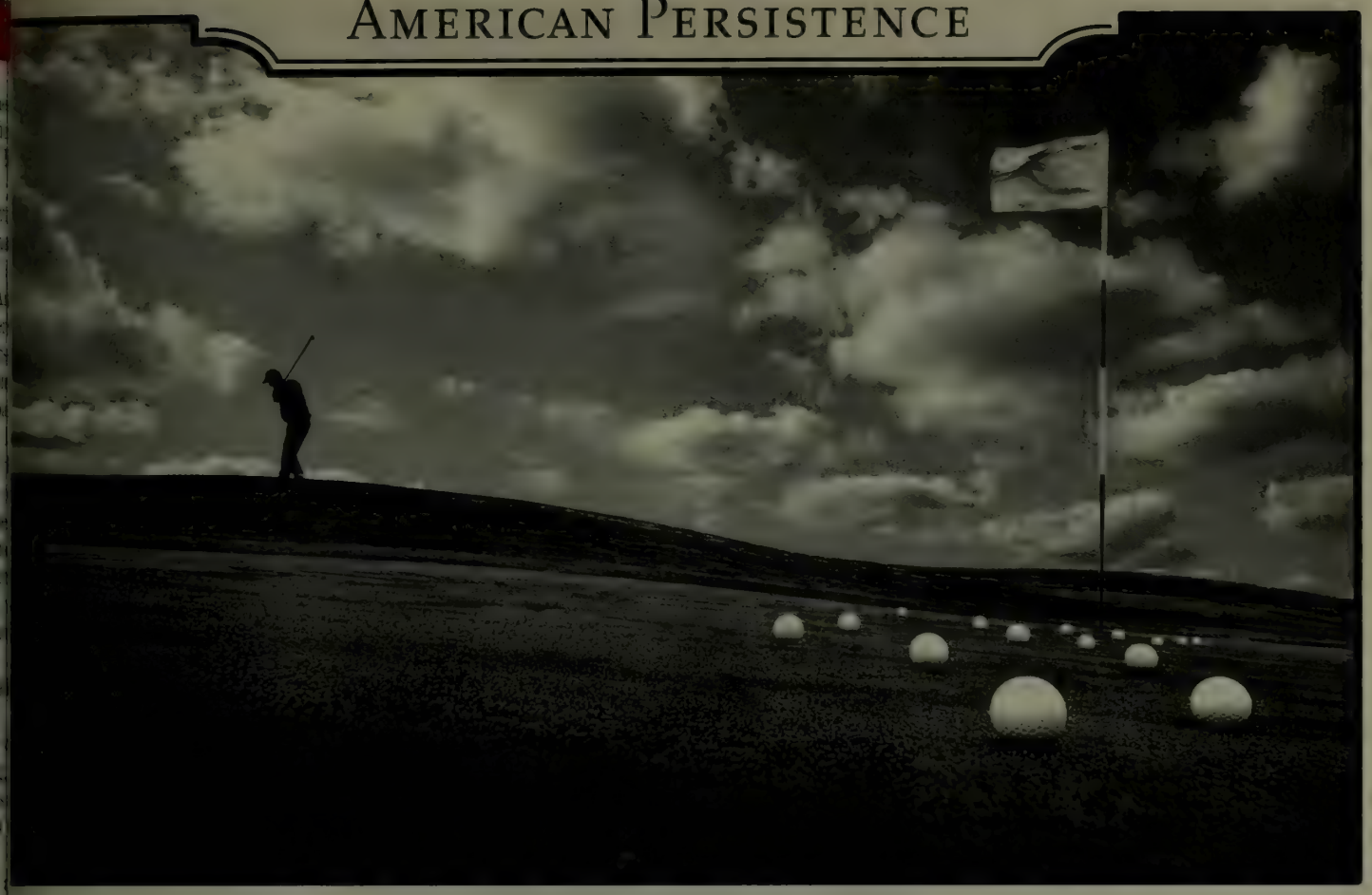
Meanwhile, Kohl's expansion in ifornia seems to be distracting m ment. The chain has opened 28 this year in the greater Los A area, where it is encountering fie sistance from entrenched player as Mervyn's and Macy's West. So alysts say the challenging exp helps explain recent stumbles at existing stores. While the retailer ways loaded up ventory, this y misjudged deman wound up havi discount heavily, dented profits. Sh also complain stores are less we and check-out longer than they

Most troubling haps, is that sales slipped at Kohl's mature outlets. raises questions the chain's growth prospects as stores become a larger percenta Kohl's locations. Deutsche Bank esti that same-store sales at outlets five old or more have declined for the three years. In June, Kohl's wors forming stores were in the Mid home to the bulk of its older shops. gomery blames a weak Midwest ec and lousy weather. If he's wrong, days of rapid growth may be behir

By Robert Berner in Ch

IN CALIFORNIA: *One of 28 new outlets*

American Persistence



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Investment Managers

In Business This Week

EDITED BY MONICA ROMAN

SATELLITES: FALLING TO EARTH

JUST A FEW YEARS AGO, space and satellite executives were boasting that commercial space was an unexplored galaxy of potential profits. Such bold predictions have come crashing down to earth. Loral Space & Communications, a satellite maker and operator, filed for bankruptcy on July 15, citing a protracted slump in telecommunications markets. As part of the reorganization, Loral plans to sell a profitable fleet of six communications satellites over North America to Intelsat.

The same day, Boeing announced it will take a $1.1 billion charge in the second quarter, reflecting higher launch costs and continued weak demand in the commercial satellite business. Boeing also said the Delta 4 rocket—its newest satellite launch system—will withdraw from commercial business to focus exclusively on U.S. government launches.

A MINI-COUP FOR SHAREHOLDERS

IT'S A SMALL STEP TOWARD corporate democracy—but shareholder activists are still calling it a win. The Securities & Exchange Commission on July 15 said it would make it easier for investors to nominate candidates for corporate boards. By September, the SEC will propose new rules that will let shareholders put a candidate on a proxy ballot if they can demonstrate that management is neglecting their interests—say, by ignoring majority votes on shareholder resolutions. Even then, the new rules won't allow enough shareholder nominees on the official ballot to win a majority on the board. The SEC is treading lightly because CEOs cherish their ability to handpick board members. But shareholder activists say even a little democracy could boost board accountability.

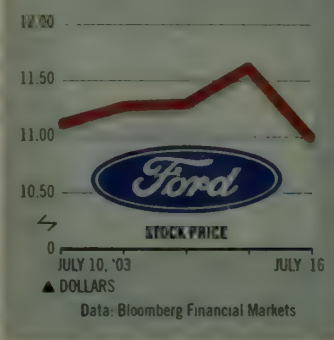
AN AIRLINE UNION GAINS ALTITUDE

THERE'S A RISING POWER IN the airlines. The Aircraft Mechanics Fraternal Assn. (AMFA) now represents United Airlines mechanics, after the 13,100-member group on July 14 tossed out the International Association of Machinists (IAM). The victory puts the union at the bargaining table at 5 of the nation's top 10 airlines. Unlike the IAM, AMFA has never O.K.'d any wage givebacks, which could put it at loggerheads with penny-pinching managers. The United win doubles AMFA's membership and follows failures at ousting the IAM in 1994 and 2001. But AMFA's clout will be limited initially since it inherits a six-year contract that doesn't expire until 2009.

CLOSING BELL

WHEEL-SPINNING

Ford Motor's second-quarter earnings of $417 million, reported on July 16, beat Wall Street's expectations of $348 million. But its stock still slid 6%, to $10.99 a share, that day. Why? Ford cut $1.6 billion in costs in the quarter, and management doesn't expect to repeat that performance in the second half.



HEADLINER: PAT RUSSO

A PROMISE UNFULFILLED

Will Lucent Technologies CEO Patricia Russo ever whip the telecom-equipment maker back into shape? She promised last October to break its losing streak by the close of the 2003 fiscal year, which ends in September.

While Russo has managed to cut costs and improve margins since taking the helm a year and a half ago, those efforts haven't kept pace with declining sales. The result: On July 15, Lucent said it would not return to profitability until 2004. It also said revenues for the third fiscal quarter ended in June will be about $2 billion, or 18% below its $2.4 billion target. Share dropped 13% the next d to $1.68.

The culprits: a slow down in the sale wireless equipment in the U. and the unexpe ed delay of a bi contract, which some analysts b lieve is with Indi wireless carrier Re liance. Paul Sagawa of Sanford Bernstein says t company faces no risk of bankruptcy, because it h $4.9 billion in cash. But more cost cuts, including layoffs, are inevitable. A while Russo's job appear safe, a shakeup in the wireless unit looks likely

Steve Rosenbu

INTEL: A CHARGE FROM WIRELESS

INTEL'S BETS ON NEW TECHnologies are paying off. On July 15, the chipmaker reported second-quarter earnings doubled, to $896 million, from the year-ago period. Intel attributed the results in part to strong demand for its new Centrino wireless notebook-PC package and its Hyperthreading technology for desktop chips, which makes one processor act like two. Intel predicted cost-cutting, new plants, and premium pricing could boost profit margins in the second half. Investors bid up its shares 5%, on July 16, to $25.31, a 52-week high.

EDISON GOES PRIVATE AGAIN

EDISON SCHOOLS IS GIVING UP on getting Wall Street to invest in its elusive dream of making money running p schools. Four years after ing public at $18 a sh Edison's board on July 14 proved a bid by CEO Chr pher Whittle and Lib Partners to take the com private for $1.76 a shar 4% premium over the cur price. Although the de subject to shareholder vo would remove Edison's nances from the limelight, company is certain to att controversy, as it strive do a better job than pu schools of educating stude

ET CETERA . . .

■ Scholastic, the U.S. p lisher of Harry Potter bo plans to cut spending.

■ IBM had a second-qua net profit of $1.7 billion, $56 million a year earlier.

■ The U.S. Attorney's of subpoenaed Tenet Health for documents related physician-relocation practi

RICHARD S. DUNHAM

BUSH'S CREDIBILITY GAP: DEMOCRATIC FANTASY OR TOMORROW'S REALITY?

Instead of a summer sipping iced tea and watching blockbusters such as *Terminator 3*, President George W. Bush is sitting through endless reruns of a political shoot-'em-up I might call *Showdown at Credibility Gap*. Using 16 ill-fated words in the State of the Union address as a jumping-point, Bush's Democratic critics have launched a broad assault on his character. "This Administration already has a murky relationship with the truth," says Senator John F. Kerry (D-Mass.), a 2004 White House aspirant. "George Bush already went back on his word on education funding, the environment, the deficit, and...the costs of the war in Iraq."

Even before the weapons of mass destruction debacle, Bush was facing headwinds from a struggling economy and mounting U.S. casualties in Iraq. But the flap over unverified claims that Iraq attempted to buy uranium from Niger could be even more serious. Democrats, joined by maverick Republican Senator John McCain (Ariz.), want congressional hearings to examine whether the Administration knowingly used false justifications or pressured intelligence agencies to shade their findings in the runup to war. Two Democratic candidates on July 16 called for the resignation of designated scapegoat George J. Tenet, the CIA director (BW—June 23), and top Pentagon policymakers. Bush loyalists dismiss the current media frenzy as a Washington sideshow fomented by desperate Democratic Presidential contenders. Perhaps. But the fierce assault on Bush's credibility still threatens to knock the halo off the head of the politician that 75% of Americans view as a strong, decisive leader, according to a June 27-29 Gallup Poll.

To de-lionize Bush, Democrats are borrowing a page from the 2000 battle plan of White House political guru Karl Rove. That's as the GOP successfully painted Al Gore as a serial exaggerator, Bush's foes are alleging a Presidential pattern of playing fast and loose with the facts. White House hopeful Senator John Edwards (D-N.C.) denounces "this Administration's problem with telling the truth when it conflicts with its political agenda." Connecticut Senator Joseph I. Lieberman, Gore's former running mate, says the exploding deficit is yet another example: "They underestimate the size of the hole we're in. And worse, they're hiding behind the war and homeland security to excuse their own fiscal irresponsibility."

In the past, Democrats had high hopes of turning opportunities such as the Enron scandal and the corporate crime wave into cutting critiques of George W. But in both cases, a nimble White House was able to neutralize the damage. This time the Bush communications team, renowned for message discipline and crisis management, has been slow to offer a coherent response. One result: A July 9-10 ABC News/*Washington Post* Poll found that 50% of voters believe that the Administration intentionally exaggerated its evidence of Iraqi weaponry. Perhaps more important, the percentage of Americans calling Bush honest and trustworthy fell to 65% in late June, from 74% a month earlier, according to Gallup.

AL AND GEORGE: *Who's exaggerating now?*

Those are still impressive numbers. But the trend line worries GOP strategists. Bush could try to put the issue behind him by offering up a sacrificial staffer. But he is always loath to give in to critics, and any sign of White House weakness might lead to escalating demands for political blood.

If the President chooses to tough it out, he'll bank on Democrats overreaching as they try to tar his regular-guy, straight-talker image. And the public could tire of the midsummer melodrama. Still, if more examples of dissembling come to light, staying the course could backfire big time.

CAPITAL WRAPUP

FCC ON THE HOT SEAT

The battle against media deregulation is heating up. In passing a $279 million defense spending bill on July 16, the House Appropriations Committee prohibited the FCC use to implement a new rule allowing TV networks to own local stations reaching up to 45% of the nation's audience. Instead, the agency would have to stick to its previous 35% cap.

A day earlier, a bipartisan group of Senators, including Byron Dorgan (D-N.D.), Dianne Feinstein (D-Calif.), Trent Lott (R-Miss.), and Susan Collins (R-Me.), introduced a rarely used legislative veto to undo new FCC media rules, including one allowing newspapers to own broadcast stations where they publish.

Foes of deregulation face a tough slog, though. The Senate veto is largely symbolic because the House GOP leadership vows to block it. And on July 10, the National Association of Broadcasters withdrew support for a return to the 35% cap because it fears other changes, such as a ban against newspaper-broadcast mergers. The Network Affiliated Stations Alliance, however, a group of over 600 network affiliates, vows to fight on.

HOWARD DEAN, BLOGGER

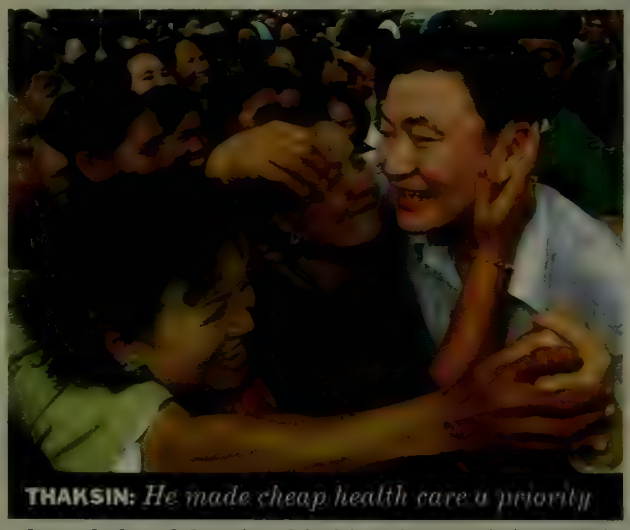
► Not only is Democratic Presidential candidate Howard Dean raising big bucks on line, but he's also the first to host a Web log, cogitating at blogforamerica.com. And on July 14, Dean began filling in for vacationing Larry Lessig, a Stanford University law prof whose site has a huge following among technoids and cyber-libertarians. Campaign Manager Joe Trippi says Dean writes the blog himself.

ASIA

THAKSIN'S THAILAND

It's prospering–but at what cost?

It's nearly 10 p.m., and the new Carrefour hypermarket near Bangkok's waterfront is hopping. Late-model Toyotas, Hondas, and Fords crowd the parking lot. Inside, carts are piled high with groceries. One shopper, Sunthorn Kansatian, pulls five-kilogram sacks of rice from the shelves. The rice is for monks at a Buddhist temple where he's celebrating his birthday—a luxury he hasn't enjoyed since Thailand went into a financial tailspin in 1997, dragging his business of selling household goods down with it. "In the past two years, life has gotten better," says 44-year-old Sunthorn. "Now everyone has money in their pockets."



THAKSIN: *He made cheap health care a priority*

Sunthorn may be bringing rice to the temple, but he doesn't say it's the monks who have improved his fortunes. The real credit, Sunthorn will tell you, goes to Thaksin Shinawatra, Thailand's Prime Minister since January, 2001. Thaksin's policies of cheap loans to farmers and workers have helped Sunthorn's customers start buying again. So Sunthorn has twice sought out Thaksin to thank him. "I just said, 'Hello, how are you?'" Sunthorn recalls. On both occasions, Thaksin waved. Not much, but enough to satisfy his admirer. "The Prime Minister can talk to people of every level," Sunthorn says.

Sunthorn isn't alone in his admiration for Thaksin, a telecom tycoon worth as much as $2 billion. After 2½ years in office, Thaksin has approval ratings of some 70%. Economic growth hit 5.3% last year and clocked 6.7% in the first quarter this year, one of Asia's fastest rates. That came as a surprise to many who had written off the region as flattened by the 1997 crisis and suffocated by China.

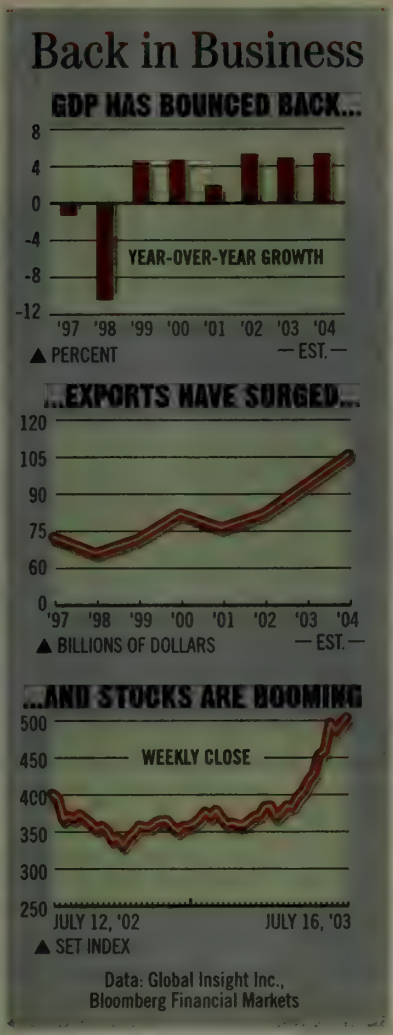
Thais might have bought into that pessimism once, but they sure don't now. The Bangkok stock exchange is up 41% for the year. Hard-currency reserves stand at $40 billion. Interest rates have fallen to 1.25%, their lowest level since the crisis. Thaksin is helping the poor with affordable medical care and microloans to small businesses. He's cracking down on drugs, prostitution, and organized crime by ordering police sweeps and going after elected officials and civil servants accused of corruption. "The bottom line is to improve the lives of the people, make the country progress, and bring peace to society," says Thaksin.

Yet while many Thais admire Thaksin and his accomplishments, others are uneasy. Opponents fear Thaksin is increasing his grip on power by cutting down potential rivals and filling key government and military posts with family members and associates from Shin Corp., his telecom and media empire. They say he targets Thailand's nongovernmental organizations and p to a brutally effective campaign aga drug dealers as an assault on rights. Finally, there's concern that alienating foreign investors and that pump-priming will set the economy for a fall once the stimulus stops. "nothing but an opportunist," says a

BANGKOK: *Denizens can ride above tr*

(L TO R) PORNCHAI KITTIWONGSAKUL/AFP PHOTO/GETTY IMAGES; STEPHEN SHAVER/AFP PHOTO/GETTY IMAGES

...and they'll soon have a subway, too



adviser to Chuan Leekpai, ksin's predecessor. "He's going to he country into trouble."

ough charges. Thaksin denies any roper acts and bristles at accusa- that he is abusing his position for cial gain. "No way," he says. "Very people say that." Nepotism? A esman says the Prime Minister's ives and associates earned their jobs. The police crackdown? "Everything we have done has been according to the Thai constitution," insists Thaksin.

Controversy will clearly dog Thaksin throughout his career. But if he can keep the economy roaring—and that's still unclear—Asia and the world will be hearing plenty more from him. Unlike any other democratically elected Prime Minister in Thai history, Thaksin seems likely to complete a full four-year term and not get toppled in a military coup or a no-confidence motion in Parliament. By all accounts, he will be handily reelected at the next polls, expected in 2005.

That would give him at least eight years on the world stage—which would suit Thaksin just fine. He makes it clear that he wants to play successor to Malaysia's Mahathir Mohamad or Singapore's Lee Kuan Yew as an aggressive advocate of Asian growth backed by a strong hand. Thaksin, who turns 54 on July 26, especially admires Mahathir's combative stance. "Dr. Mahathir sings *My Way*. I sing, *Love Me, Love My Dog*," Thaksin quips.

Thaksin courts the West in some ways and wants a free-trade agreement with the U.S. But he also bears a message of Asian power. In a June 5 speech, he called for the creation of a new class of Asian bond that the region's governments could issue and invest in instead of putting funds into U.S. Treasuries. "Our reserves," said Thaksin, "when deposited in bonds in the West, created more wealth [for] the Western hemisphere without contributing to our own growth."

Whether savior, troublemaker, or opportunist, Thaksin is a complex character. At a young age, he developed a fascination with law enforcement and won a Thai government scholarship to study criminal justice in the U.S., earning a master's degree from Eastern Kentucky University in Richmond, Ky., and a PhD from Sam Houston State University in Huntsville, Tex. On returning to Thailand, he joined the police, where he learned to work official connections and got a glimpse of the benefits of power. After a couple of failed attempts at starting a business, he and his wife in 1982 set up a company that won a contract selling computers to the police. The company, which grew into Shin Corp., today owns iTV—Thailand's biggest private broadcaster—and controls the country's leading cellular carrier.

In 1998, Thaksin formed a political party, then swept into power in 2001. But he hardly got off to an auspicious start. During the campaign, he was indicted for failing to disclose all of his assets and then was acquitted by just one vote in the Constitutional Court. Yet once in office, he immediately moved to enrich workers. Since 2001, his administration has earmarked some $13 billion for loans for everything from farms and PCs to vacations for civil servants. "We're pumping in money to create income and jobs," contends Thaksin.

The economy is certainly humming. Farm incomes rose 11% last year. Exports surged 18% in the first half, thanks in part to sustained low costs from the depreciation of the baht, now 40% weaker than it was in 1997. Thailand Inc. is thrilled. "There's a strong hint of CEO-type management in Thaksin," says Chumpol Nalamlieng, president and CEO of Siam Cement Public Co., whose company is flourishing.

Thaksin says he expects growth of 6% for this year, followed by 7% in 2004 and 8% in 2005. Estimates from independent analysts range from 3.5% to 5.5%. Whatever the growth, the changes are evident in Thailand's villages. Freshly built houses dot the countryside, and

CHARTS BY ERIC HOFFMANN/BW

In spite of rapid growth, the banking sector still suffers from recurring problem loans and low profits

new motorbikes abound. One farmer who has prospered is Thanom Yothana. The stocky 55-year-old borrowed $476 from the state-backed Village Development Fund, using the money to add a new catfish pond to his farm. That boosted his income enough to build a two-story house and buy an $18,000 Toyota pickup truck. "I'll be able to pay my debt on time," Thanom says while tossing feed into a pond teeming with catfish. "Next year I'll borrow more."

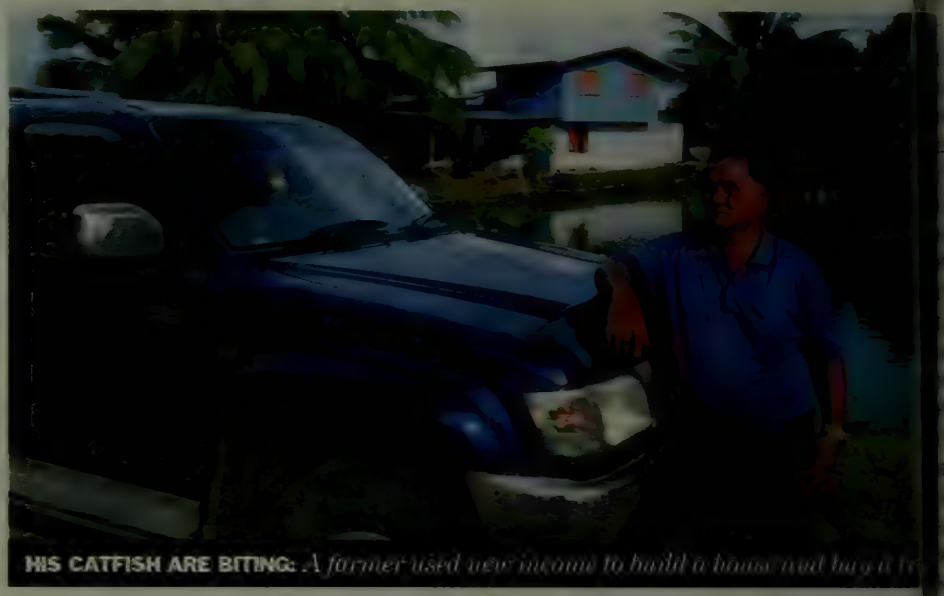
Thailand's thriving auto sector is also helping Thaksin. General Motors Corp., for instance, in May, 2000, started exporting its Opel Zafira to Germany from its cavernous plant in Rayong Province. The sport-utility vehicle—GM's first Thai-built car aimed at the German market—quickly caught on among Thais. With Thaksin's easy credit policies, Thais bought 17,000 Zafiras last year, 10% of GM's production.

CEO is one role the Prime Minister plays; Top Cop is the other. There's little doubt that his crackdown on crime has made the country safer, but that safety has come at a cost. Since February, nearly 2,400 people allegedly involved in the narcotics trade have been gunned down, according to the government-funded National Human Rights Commission. "This is a massacre," says Pradit Chareonthaitawee, head of the commission, which is investigating a number of the killings in which Pradit believes the police played a part.

The government acknowledges that rogue cops in league with drug dealers are responsible for some killings, says a Thaksin spokesman, and vows to punish any police found guilty. Police have also been involved in a handful of fatal shootouts in the line of duty, the spokesman says, but most of the killings were carried out by drug dealers eliminating rivals or potential witnesses against them. Pradit agrees drug dealers were responsible for some of the killings.

Thaksin insists police target only wanted criminals in the sweep.

DRUG SWEEP: *A deadly police crackdown in Bangkok*



HIS CATFISH ARE BITING: *A farmer used new income to build a house and buy a t*

"As long as they don't have a criminal case, we are not going to bother them," he says. Yet he hardly sounds like a committed democrat: "Democracy is the means to an end, not the end itself." In March, he rejected U.N. criticism of his human rights record, saying "The U.N. is not my father." He later retracted the remark, saying he had "overreacted."

As Thaksin's confidence grows, he is also revealing a nationalist streak in economic matters that investors find irksome. His administration discouraged foreign retailers with proposed regulations that would have made it more difficult to open stores in Thailand, although those plans were scrapped when foreign companies protested. Still, foreign direct investment last year fell to $900 million, from $3.8 billion in 2001, World Bank data show.

Critics also complain Thaksin has not done enough to heal banking. Nonperforming assets in the financial system fell to 30% last year, according to official data, from a peak of nearly 50% in 1999. Bankers in Bangkok suspect actual figures are higher. "Thailand has improved, but it's still standing on shaking knees," says Nancy Koh, an analyst at Standard & Poor's in Singapore.

With so much easy credit flowing to the poor, some fear Thaksin may have hooked the omy on debt. "When you start this of thing, you can't stop," warns Ar Chewakrengkai, director of stra analysis at the Government Per Fund in Bangkok. The Prime Min isn't worried. "Some people think poor...never honor their loans," he "But they are much better than businesspeople."

As the economy grew and tax enues soared, public debt as a sha GDP fell to 54% last year, from 70% fore he came to office. Thaksin i ready working on his next project wants to grant deeds of ownershi vendors and shop owners in the ur ground economy. That way, a ve could prove to a bank that he own pushcart and get a microloan using cart as collateral. The money woul into the business and produce tax income. "We'll bring up the undergr economy," says Thaksin.

He hopes the initiative—comb with his other programs—will add a percentage point to Thailand's GDP raise enough taxes to help balance budget. Punishment for the crimi Profits for the poor. It's brilliant pol Will Thaksin transform Thailand or it up for another crisis? Either way, cop-turned-tycoon-turned-Prime M ter is leaving his mark.

By Michael Shari in Bang

BusinessWeek online

For a Q&A with Thaksin, go to www.businessweek.com/magazine/extras.

)W THAT'S)NTINENTAL FLAIR

ːse exceptional companies thrive in good times and bad

ame an economic malady and Eu-rope has it right now: sluggish eco-nomic growth, lackluster consumer ding, and depressed stock markets. that reason, *BusinessWeek* could ave picked a better time to launch rst annual ranking of Europe's 50 -performing companies. You won't any frothy flavor-of-the-month out-among these stalwarts. Patterned the BW 50, which lists the gest companies in the U.S., the pean BW 50 is studded with com-es whose managers know how to e money in good times and bad. t do corporations such as British HBOS (No. 1), Swedish apparel re-r H&M Hennes & Mauritz (No. 8), French carmaker Peugeot (No. 15) in common? All have made singu-rogress in boosting sales, increasing ts, and delivering superior returns vestors in these worst mes for much of Eu-. "Such top perform-excel mainly because od management that s what to do in a dif-environment," says rt Parkes, an analyst SBC Bank in London. lly annotated list of 0 and of the Standard & Poor's Europe 350 from which they are drawn, is available online along with a detailed analysis.

U.S. readers will see many familiar names among the 50. That's because the most successful European companies tend to be global players. Energy companies like Total and financial-services companies such as HSBC Holdings figure prominently. So do marketing giants such as Switzerland's Nestlé and British American Tobacco. Notable by their absence are most of Europe's big technology and telecom companies. Blame their poor showing on three years of weak revenue growth, poor profits, and, most of all, sagging stock market valuations.

As investors know all too well, companies can manage impressive profits one year and disappoint the next. That's why the European BW 50 rewards those with staying power, basing its rankings on the performance of the companies in the S&P's Europe 350 stock index over both one and three years. Readers should not look at the Europe ranking as an investment guide. Even stellar performers have their ups and downs. German pharmaceutical firm Altana and Spanish construction and engineering company Grupo Dragados, for instance, beat all comers with total returns of 160.2% and 140.6%, respectively, between June 30, 2000, and June 30, 2003. But their returns over the past 12 months have disappointed.

There's a definite British tilt to the European BW 50: British outfits account for 17 of the 50 and 6 of the top 10. In part, that's because Britain has the most publicly traded companies of any European nation. Other elements are at work, though: The British economy has outperformed the euro zone, and British companies operate in a freer environment. By contrast, not a single German company is among the top 20.

Europe's companies face challenges over the next year. Recovery looks unlikely in the near term and the strong euro is hurting exporters. Despite the uncertainties, the companies likely to thrive are those that can do what these winners have done: cut costs, widen margins, and develop a more lucrative relationship with customers.

By David Fairlamb in Frankfurt, with bureau reports

BusinessWeek online

For the complete European BW 50 rankings and related stories, go to businessweek.com/magazine/extra/htm

THE EUROPEAN BUSINESSWEEK 50

HBOS Britain	18 **NESTLE** Switzerland	35 **BANCO POPULAR ESPANOL** Spain
GLAXOSMITHKLINE Britain	19 **RENAULT** France	36 **REPSOL YPF** Spain
ROYAL BANK OF SCOTLAND Britain	20 **BRITISH AMERICAN TOBACCO** Britain	37 **ALLIED IRISH BANKS** Ireland
ELECTRABEL Belgium	21 **BMW** Germany	38 **TIM** Italy
ALTADIS Spain	22 **BANCA POPOLARE DI VERONA** Italy	39 **ROYAL DUTCH PETROLEUM** Netherlands
RAS Italy	23 **TOTAL** France	40 **RECKITT BENCKISER** Britain
CENTRICA Britain	24 **STATOIL** Norway	41 **MARKS & SPENCER GROUP** Britain
H&M HENNES & MAURITZ Sweden	25 **ALTANA** Germany	42 **GRUPO DRAGADOS** Spain
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Data: Standard & Poor's Compustat Global Data

COMMENTARY

By Jason Bush

SIZZLING GROWTH COULD SINGE RUSSIA'S ECONOMY

Russia has a knack for defying expectations. Next month marks the fifth anniversary of one of the blackest days in Russia's post-Soviet history: the great ruble crash and debt default of Aug. 17, 1998. Yet today, Russia's economy has never looked healthier. Growth is spiking upward, inflation is falling, Russia's external trade and government finances are both in surplus, foreign debt is low, and foreign exchange reserves are mushrooming. It almost seems too good to be true.

MOSCOW MALL
Incomes are expandi 8% to 10% a year

Perhaps it is. No matter how strong Russia's economy looks on the surface, there's never been any shortage of predictions that boom will turn to bust.

Even growth can pose risks. Gross domestic product looks set to grow by 6%, while investment is rising 14% year-on-year. This has some experts fretting that the economy is growing too fast for its own good. "Russia's economy is like an amateur bodybuilder on steroids," says Roland Nash, head of research at Moscow investment bank Renaissance Capital. But he adds: "At least it is now a bodybuilder and not a corpse."

Joking aside, Nash is on to something: It's not clear how an underdeveloped Russia can keep absorbing the vast amounts of money now flooding into it. Higher prices for oil are fueling trade surpluses on the order of $30 billion annually. That in turn feeds the money supply, which is growing this year by 30% to 40%.

The wash of rubles has some positive benefits: It is feeding economic growth and finding its way into the paychecks of ordinary Russians, whose real incomes are expanding by 8% to 10% a year. But it also is feeding a boom in asset prices. The Russian equity market has risen 30% since the start of the year, while the demand for Treasury bills is now so excessive that inflation-adjusted yields are negative. Moscow real estate prices have jumped about 25% over the last 12 months. "There's no way an economy can deal with negative real interest rates and the money supply growing by 30% without some sort of macro problem," says Nash.

The asset-price explosion invites worrying parallels with 1997-98, when the Russian market boomed before crashing. A bubble is definitely possible. The good news is that Russia is much better equipped to prevent a meltdown if the bubble bursts. Its '98 crash had a lot to do with an overvalued exchange rate and a huge hole in government finances. Neither of these is a big problem now. Plus, the central bank's foreign reserves—$60 billion and rising—means Russia can defend any attack on the ruble.

The most likely trigger for a crisis would be an oil price crash. Yet few expect prices to drop below $20 a barrel, a level more than adequate to yield healthy profits for Russian oil companies and revenues for the state.

If a drop in oil can be managed, what could unhinge the recovery? Politics. The first risk is that something happens to end the truce between the business elite and President Vladimir V. Putin, who, it was widely assumed, was keen to reassure Russian barons their assets were safe from renationalization. This implicit understanding has bolstered much of Russia's recent growth and stability. So investors got a jolt when, in early July, prosecutors launched criminal investigations of senior managers at Yukos, Russia's largest oil company and a pioneer in good corporate governance. Analysts have linked the probe to the political ambitions of Yukos Chairman Mikhail B. Khodorkovsky, who said he'd finance two opposition parties in upcoming parliamentary elections. The investigations have alarmed all of Russia's leading businessmen. And the episode underlines the risks that investors were starting to forget. "Every time someone said, 'Now it's clear what will happen,' there came a new surprise," says Christof Ruehl, chief economist at the World Bank in Moscow.

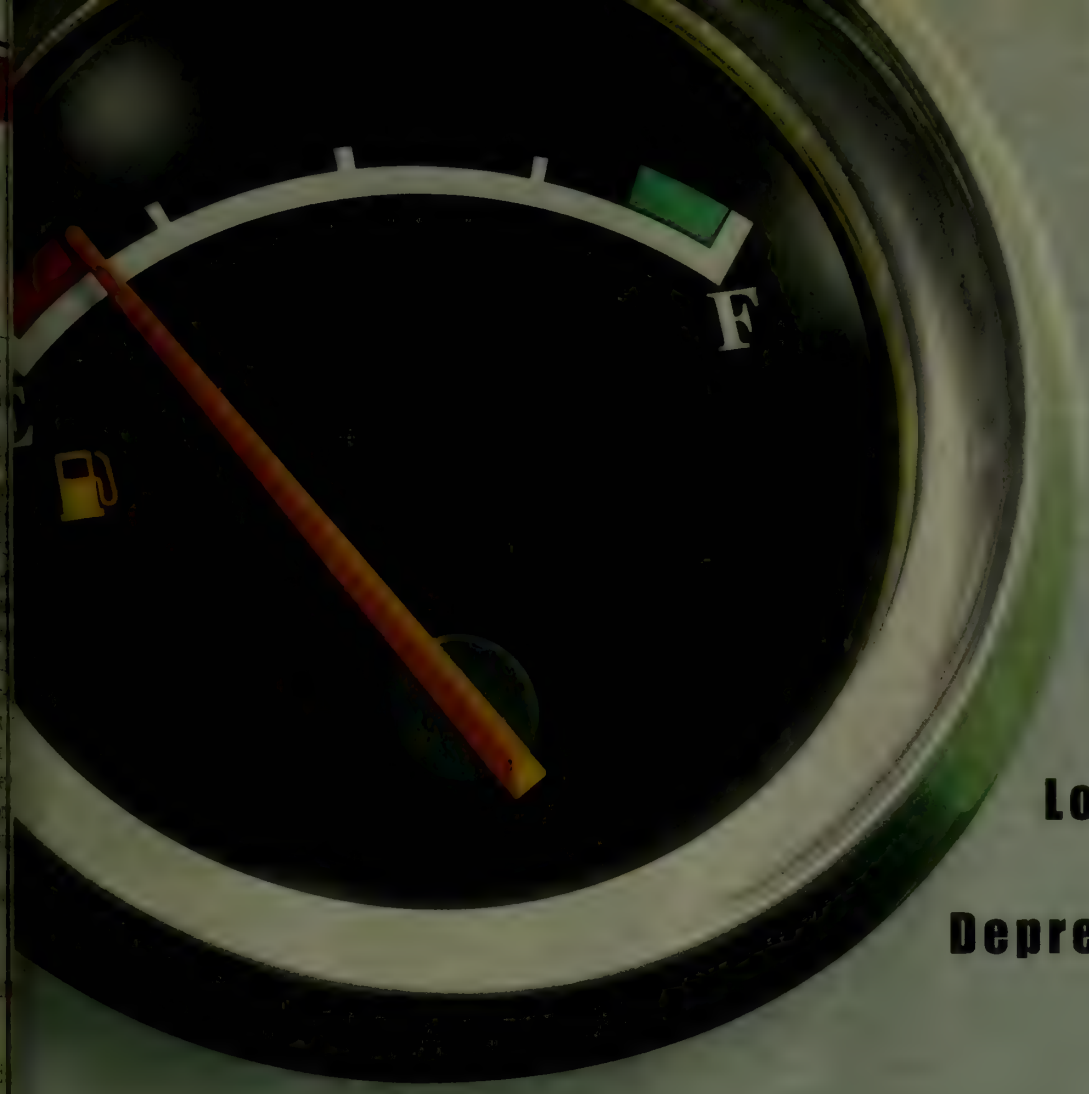
The second risk is that Putin will delay crucial reforms until after the March presidential election. He should be toughening up regulations on banks, slashing the bureaucracy, and completing the tax and legal overhaul he launched. Putin can't delay too long: Russia needs a second act after oil. A repeat of 1998 is unlikely. But even Russia's President should beware the nasty surprises Russia can produce.

Bush covers Russian business and finance from Moscow

Russia Then and Now

	1997	2003
BUDGET BALANCE (% GDP)	–7.8	1.2
CURRENT-ACCOUNT BALANCE (% GDP)	0.0	6.9
FOREIGN DEBT/GDP	35.8%	27.1
FOREIGN EXCHANGE RESERVES	$12.9 billion	$68 billion

Data: Troika Dialog



4-5 million men have low testosterone.[1]

Fatigued?

Low sex drive?

Depressed mood?

Your testosterone could be running on empty.

stosterone (hypogonadism) can cause a number of different symptoms
low sex drive, fatigue, depression, and even loss of height or strength.
ctor can check your testosterone level with a simple blood test.

tore your testosterone with easy-to-use AndroGel®

tely you can replace testosterone with AndroGel
delivers natural testosterone in a gel that you simply
your skin once a day – no patches or injections. As
orbed through your skin, AndroGel treats hypo-
m by restoring your testosterone to its normal range.

ion: AndroGel is indicated for replacement therapy in
or conditions associated with a deficiency or absence
genous testosterone, such as primary hypogonadism
gonadotropic hypogonadism.

Safety Information:

- Androgens are contraindicated in men with carcinoma of the breast, or known or suspected carcinoma of the prostate. Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.[2]
- The most frequent adverse events reported by ≥5% of patients associated with the consistent use of AndroGel after 30 months follow-up in a controlled trial (n=93) included lab test abnormal, acne, prostate disorder and application site reaction.[3]

Please see accompanying brief summary of Important Safety and Prescribing Information.

1-866-ANDROGO (263-7646)

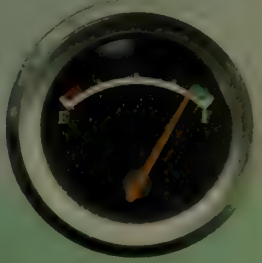
your doctor if AndroGel is right for you.

www.androgel.com

1. www.fda.gov/fdac/departs/196_upd.html, accessed on May 17, 2002. **2.** AndroGel® Prescribing Information, naceuticals, Inc., 2002. **3.** Wang C, Swerdloff RS, Iranmanesh A, et al. Long-term efficacy and safety of testosterone gel (AndroGel®) in hypogonadal men. Poster presentation #P2-646 at the 84th Annual Meeting nne Society, June 19-22, 2002, San Francisco, CA.

AndroGel®
(testosterone gel) 1% CIII

Testosterone restored



aceuticals

©2003, Solvay Pharmaceuticals, Inc.
AndroGel® is a registered trademark of Unimed Pharmaceuticals, Inc., a Solvay Pharmaceuticals Inc. Company.

AndroGel®
(testosterone gel) 1% CIII

INDICATIONS AND USAGE
AndroGel® is indicated for replacement therapy in males for conditions associated with a deficiency or absence of endogenous testosterone:
1. Primary hypogonadism (congenital or acquired)—testicular failure due to cryptorchidism, bilateral torsion, orchitis, vanishing testis syndrome, orchiectomy, Klinefelter's syndrome, chemotherapy, or toxic damage from alcohol or heavy metals. These men usually have low serum testosterone levels and gonadotropins (FSH, LH) above the normal range.
2. Hypogonadotropic hypogonadism (congenital or acquired)—idiopathic gonadotropin or luteinizing hormone-releasing hormone (LHRH) deficiency or pituitary-hypothalamic injury from tumors, trauma, or radiation. These men have low testosterone serum levels but have gonadotropins in the normal or low range.

AndroGel® has not been clinically evaluated in males under 18 years of age.

CONTRAINDICATIONS
Androgens are contraindicated in men with carcinoma of the breast or known or suspected carcinoma of the prostate.

AndroGel® is not indicated for use in women, has not been evaluated in women, and must not be used in women.

Pregnant women should avoid skin contact with AndroGel® application sites in men. Testosterone may cause fetal harm. In the event that unwashed or unclothed skin to which AndroGel® has been applied does come in direct contact with the skin of a pregnant woman, the general area of contact on the woman should be washed with soap and water as soon as possible. *In vitro* studies show that residual testosterone is removed from the skin surface by washing with soap and water.

AndroGel® should not be used in patients with known hypersensitivity to any of its ingredients, including testosterone USP that is chemically synthesized from soy.

WARNINGS
1. Prolonged use of high doses of orally active 17-alpha-alkyl androgens (e.g., methyltestosterone) has been associated with serious hepatic adverse effects (peliosis hepatis, hepatic neoplasms, cholestatic hepatitis, and jaundice). Peliosis hepatis can be a life-threatening or fatal complication. Long-term therapy with testosterone enanthate, which elevates blood levels for prolonged periods, has produced multiple hepatic adenomas. Testosterone is not known to produce these adverse effects.
2. Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.
3. Geriatric patients and other patients with clinical or demographic characteristics that are recognized to be associated with an increased risk of prostate cancer should be evaluated for the presence of prostate cancer prior to initiation of testosterone replacement therapy. In men receiving testosterone replacement therapy, surveillance for prostate cancer should be consistent with current practices for eugonadal men (see PRECAUTIONS: Carcinogenesis, Mutagenesis, Impairment of Fertility and Laboratory Tests).
4. Edema with or without congestive heart failure may be a serious complication in patients with preexisting cardiac, renal, or hepatic disease. In addition to discontinuation of the drug, diuretic therapy may be required.
5. Gynecomastia frequently develops and occasionally persists in patients being treated for hypogonadism.
6. The treatment of hypogonadal men with testosterone esters may potentiate sleep apnea in some patients, especially those with risk factors such as obesity or chronic lung diseases.

PRECAUTIONS
Transfer of testosterone to another person can occur when vigorous skin-to-skin contact is made with the application site (see Clinical Studies). The following precautions are recommended to minimize potential transfer of testosterone from AndroGel®-treated skin to another person:

- Patients should wash their hands immediately with soap and water after application of AndroGel®
- Patients should cover the application site(s) with clothing after the gel has dried (e.g., a shirt).
- In the event that unwashed or unclothed skin to which AndroGel® has been applied does come in direct contact with the skin of another person, the general area of contact on the other person should be washed with soap and water as soon as possible. *In vitro* studies show that residual testosterone is removed from the skin surface by washing with soap and water.

Changes in body hair distribution, significant increase in acne, or other signs of virilization of the female partner should be brought to the attention of a physician.

General
The physician should instruct patients to report any of the following:
- Too frequent or persistent erections of the penis.
- Any nausea, vomiting, changes in skin color, or ankle swelling.
- Breathing disturbances, including those associated with sleep.

Information for Patients
Advise patients to carefully read the information brochure that accompanies each carton of 30 AndroGel® single-use packets.

Advise patients of the following:
- AndroGel® should not be applied to the scrotum.
- AndroGel® should be applied once daily to clean, dry skin.
- After application of AndroGel,® it is currently unknown for how long showering or swimming should be delayed. For optimal absorption of testosterone, it appears reasonable to wait at least 5-6 hours after application prior to showering or swimming. Nevertheless, showering or swimming after just 1 hour should have a minimal effect on the amount of AndroGel® absorbed if done very infrequently.

Laboratory Tests
1. Hemoglobin and hematocrit levels should be checked periodically (to detect polycythemia) in patients on long-term androgen therapy.
2. Liver function, prostatic specific antigen, cholesterol, and high-density lipoprotein should be checked periodically.
3. To ensure proper dosing, serum testosterone concentrations should be measured (see DOSAGE AND ADMINISTRATION).

Drug Interactions
Oxyphenbutazone: Concurrent administration of oxyphenbutazone and androgens may result in elevated serum levels of oxyphenbutazone.

Insulin: In diabetic patients, the metabolic effects of androgens may decrease blood glucose and, therefore, insulin requirements.

Propranolol: In a published pharmacokinetic study of an injectable testosterone product, administration of testosterone cypionate led to an increased clearance of propranolol in the majority of men tested.

Corticosteroids: The concurrent administration of testosterone with ACTH or corticosteroids may enhance edema formation; thus, these drugs should be administered cautiously, particularly in patients with cardiac or hepatic disease.

Drug/Laboratory Test Interactions
Androgens may decrease levels of thyroxin-binding globulin, resulting in decreased total T4 serum levels and increased resin uptake of T3 and T4. Free thyroid hormone levels remain unchanged, however, and there is no clinical evidence of thyroid dysfunction.

Carcinogenesis, Mutagenesis, Impairment of Fertility
Animal Data: Testosterone has been tested by subcutaneous injection and implantation in mice and rats. In mice, the implant induced cervical-uterine tumors, which metastasized in some cases. There is suggestive evidence that injection of testosterone into some strains of female mice increases their susceptibility to hepatoma. Testosterone is also known to increase the number of tumors and decrease the degree of differentiation of chemically induced carcinomas of the liver in rats.

Human Data: There are rare reports of hepatocellular carcinoma in patients receiving long-term oral therapy with androgens in high doses. Withdrawal of the drugs did not lead to regression of the tumors in all cases.

Geriatric patients treated with androgens may be at an increased risk for the development of prostatic hyperplasia and prostatic carcinoma.

Geriatric patients and other patients with clinical or demographic characteristics that are recognized to be associated with an increased risk of prostate cancer should be evaluated for the presence of prostate cancer prior to initiation of testosterone replacement therapy.

In men receiving testosterone replacement therapy, surveillance for prostate cancer should be consistent with current practices for eugonadal men.

Pregnancy Category X (see Contraindications)—Teratogenic Effects: AndroGel® is not indicated for women and must not be used in women.

Nursing Mothers: AndroGel® is not indicated for women and must not be used in women.

Pediatric Use: Safety and efficacy of AndroGel® in pediatric patients have not been established.

ADVERSE REACTIONS
In a controlled clinical study, 154 patients were treated with AndroGel® for up to 6 months. Adverse events possibly, probably or definitely related to the use of AndroGel® and reported by ≥1% of the patients are listed in Table 1.

Table 1. Adverse Events Possibly, Probably or Definitely Related to Use of AndroGel® in the Controlled Clinical Trial

Adverse Event	5 g	7.5 g	10 g
Acne	1%	3%	8%
Alopecia	1%	0%	1%
Application Site Reaction	5%	3%	4%
Asthenia	0%	3%	1%
Depression	1%	0%	1%
Emotional Lability	0%	3%	3%
Gynecomastia	1%	0%	3%
Headache	4%	3%	0%
Hypertension	3%	0%	3%
Lab Test Abnormal*	6%	5%	3%
Libido Decreased	0%	3%	1%
Nervousness	0%	3%	1%
Pain Breast	1%	3%	1%
Prostate Disorder**	3%	3%	5%
Testis Disorder	3%	0%	0%

**Lab test abnormal* occurred in nine patients with one or more of the following events: elevated hemoglobin or hematocrit, hyperlipidemia, elevated triglycerides, hypokalemia, decreased HDL, elevated glucose, elevated creatinine, or elevated total bilirubin.*

***Prostate disorders* included five patients with enlarged prostate, one patient with BPH, and one patient with elevated PSA results.

The following adverse events possibly related to th AndroGel® occurred in fewer than 1% of patients: anxiety, discolored hair, dizziness, dry skin, hirsutis impaired urination, paresthesia, penis disorder, per edema, sweating, and vasodilation.

In this clinical trial of AndroGel,® skin reactions at t of application were occasionally reported with And but none was severe enough to require treatment discontinuation of drug.

Six (4%) patients in this trial had adverse events tha discontinuation of AndroGel.® These events include following: cerebral hemorrhage, convulsion (neithe were considered related to AndroGel® administratio depression, sadness, memory loss, elevated prostate antigen and hypertension. No AndroGel® patients discontinued due to skin reactions.

In an uncontrolled pharmacokinetic study of 10 pat had adverse events associated with AndroGel®; thes asthenia and depression in one patient and increas and hyperkinesia in the other. Among 17 patients i clinical studies there was one instance each of acne and benign prostate adenoma associated with a 2.5 testosterone gel formulation applied dermally.

One hundred six (106) patients have received AndroG up to 12 months in a long-term follow-up study for who completed the controlled clinical trial. The preli safety results from this study are consistent with thos reported for the controlled clinical trial. Table 2 summ those adverse events possibly, probably or definitely the use of AndroGel® and reported by at least 1% of number of patients during long-term exposure to An

Table 2. Incidence of Adverse Events Possibly, Pro Definitely Related to the Use of AndroGel in the Long-Term, Follow-up Study

	Dose of AndroGel	
Adverse Event	5 g	7.5 g
Lab Test Abnormal*	4.2%	0.0%
Peripheral Edema	1.4%	0.0%
Acne	2.8%	0.0%
Application Site Reaction	9.7%	10.0%
Prostate Disorder**	2.8%	5.0%
Urination Impaired	2.8%	0.0%

**Lab test abnormal* included one patient each with GGTP, elevated hematocrit and hemoglobin, increa bilirubin, worsened hyperlipidemia, decreased HDL hypokalemia.

***Prostate disorders* included enlarged prostate, elev PSA results, and in one patient, a new diagnosis of cancer; three patients (one taking 7.5 g daily and taking 10 g daily) discontinued AndroGel® treatmen the long-term study because of such disorders.

DRUG ABUSE AND DEPENDENCE
AndroGel® contains testosterone, a Schedule III contr substance as defined by the Anabolic Steroids Contro

Oral ingestion of AndroGel® will not result in clinically significant serum testosterone concentrations due to first-pass metabolism.

OVERDOSAGE
There is one report of acute overdosage by injection testosterone enanthate: testosterone levels of up to 11,400 ng/dL were implicated in a cerebrovascular acc

DOSAGE AND ADMINISTRATION
The recommended starting dose of AndroGel® 1% is 5 delivering 5 mg of testosterone systemically, applied o daily (preferably in the morning) to clean, dry, intact s the shoulders and upper arms and/or abdomen. Upon the packet(s), the entire contents should be squeezed palm of the hand and immediately applied to the app sites. Application sites should be allowed to dry for a f minutes prior to dressing. Hands should be washed wi and water after AndroGel® has been applied.

Do not apply AndroGel® to the genitals.

Serum testosterone levels should be measured approxi 14 days after initiation of therapy to ensure proper dos If the serum testosterone concentration is below the n range, or if the desired clinical response is not achieved daily AndroGel® 1% dose may be increased from 5 g to and from 7.5 g to 10 g as instructed by the physician.

Rx Only

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Montrouge, France

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ESTMENT BANKING

HAT GREAT ALL?

gan Stanley breaks into na's financial sector

was a first-ever for China's financial ector and a major step forward in anking reform. In a July 8 ceremony n the top floor of the China Con- tion Bank (CCB) headquarters in Bei- financiers drank champagne toasts leal that paired Morgan Stanley with one of China's big four commercial s, giving Morgan Stanley bragging s as the first foreign bank to sign a t joint venture to dispose of the land's nonperforming loans.

r China, it's just the latest oppor- y to leverage Western banking ex- se to clean up a bad loan problem Standard & Poor's estimates will $500 billion to clean up. "Through this cooperation, China Construction Bank will import and use Morgan Stanley's advanced techniques." says Yang Xiaoyang, general manager of CCB'S special asset resolution department.

For Morgan Stanley, the accord also keeps the New York firm ahead of the competition. "This is part of a step-by-step development in the opening of China's marketplace," says Stephan F. Newhouse, chairman of Morgan Stanley International. The Wall Street bank has already spent nearly nine years jointly running China International Capital Corp. (CICC) with CCB. That partnership made Morgan Stanley the only Western bank privileged to do deals in China until another got permission in April. Over the years, Morgan Stanley has played its China card aggressively. In November it advised a $1.5 billion offering of China Telecommunications Corp. shares. In January it helped with Anheuser-Busch Cos.' $182 million purchase of a larger stake in Tsingtao Brewery Co.

But over the past 19 months, China has been opening its financial markets to comply with World Trade Organization commitments, and rivals are forging deep links with local partners. They include French investment bank CLSA and Switzerland's UBS, which on July 9 was the first foreign bank to invest in China's domestic "A" share stock markets. (Morgan Stanley plans to sink as much as $300 million of client funds into A shares.) And Goldman, Sachs & Co. is already duking it out with Morgan Stanley in China. "China still holds all the promise," says Richard J. Gnodde, president and managing director of Goldman Sachs (Asia) LLC. Goldman has scored some big wins such as Nissan Motor's $1 billion purchase of a 50% share of Dongfeng Motor Corp.

One issue: The communist bureaucracy isn't known for quick, ground-breaking reforms. Morgan Stanley's loan deal has yet to be cleared by People's Bank of China, the China Banking Regulatory Commission, or the Finance Ministry. A chief sticking point is what value will be put on the loans, most of them to state-run companies. "You are still not supposed to sell below book value," says one Western investment banker in China. "How do they get around that?"

Good point. CCB is asking the government for "trial permission" to sell the debt at less than par value, says John Langlois, president of Morgan Stanley Properties (China). Assuming that's resolved, the venture will be a 70%-30% joint operation with Morgan Stanley holding the majority stake. It will take on a portfolio of 700 troubled loans with a total book value of $519 million. Instead of liquidating borrowers' assets, the venture plans to help them remake themselves through debt restructuring, debt forgiveness, and refinancing. But if that fails, it may have to rely on China's untested courts to sort things out.

Morgan Stanley is pushing other deals. It aims to carry out initial public offerings for People's Insurance Co. of China and China Ping An Insurance Co. Its local property unit and Shanghai's Yong Ye Group have announced plans for a $90 million luxury residential complex in downtown Shanghai.

Will the investment banks flooding into China make any money? There are a lot of doubters, at least for the near term. Be patient, says Newhouse. "China is a place to put one's bets for the next 25 years," he says. The long march to true capital markets has started.

By Dexter Roberts in Beijing and Mark L. Clifford in Hong Kong

CHINA CONSTRUCTION BANK'S HQ

ET'S MAKE A DEAL

Western estment banks and Chinese ompanies are ing up to strike accords

APR. 25, 2003
France's CLSA signs deal with Xiangcai Securities to create China's first joint-venture investment bank since 2001

JUNE 4, 2003
Industrial & Commercial Bank of China and Goldman Sachs agree to dispose of as much as $1.2 billion in bad loans

JULY 8, 2003
Morgan Stanley inks joint venture with China Construction Bank to jointly buy up to $519 million in corporate debt

JULY 9, 2003
Swiss bank UBS does first trade in China's so-called A-shares market of stocks previously off-limits to foreigners

JULY 10, 2003
Morgan Stanley Real Estate Funds announces plans to invest $90 million in Shanghai's booming real estate sector

THE WORKPLACE

ZEN AND THE ART OF CORPORATE PRODUCTIVITY

More companies are battling employee stress with meditation

For Dave Jakubowski, vice-president of business development for Internet service provider United Online Inc., the job isn't what it used to be. Instead of an unlimited expense account and stays at the plush Chateau Marmont, the 31-year-old Manhattanite now brown-bags his lunch and stays at a Hyatt when he's in Los Angeles on business. He logs 18-hour days to help his Westlake Village (Calif.)-based company hit its quarterly sales targets of around $8 million. How to cope? Jakubowski is no breathe-like-a-tree kind of guy. "I'm in business," he says, "and I need results." So he recently turned to a mat and 60 minutes of silence. "It's amazing," he says of his new meditation practice. "I'm able to sort through work challenges in this state of calm much faster than trying to fight through it. And I make fewer mistakes."

Increasingly, the overstretched and overburdened have a new answer to work lives of gunning harder for what seems like less and less: Don't just do something—sit there. Companies increasingly are falling for the allure of meditation, too, offering free, on-site classes. They're being won over, in part, by findings at the National Institutes of Health, the University of Massachusetts, and the Mind/Body Medical Institute at Harvard University that meditation enhances the qualities companies need most from their knowledge workers: increased brain-wave activity, enhanced intuition, better concentration, and the alleviation of the kinds of aches and pains that plague employees most.

It doesn't hurt that meditation has some high-profile corporate disciples, including bond-fund king William H. Gross, of Newport Beach (Calif.)'s Pacific Investment Management Co., who often meditates with yoga before a day of trading at his $349 billion money-management firm. Tech outfits like Apple Computer, Yahoo!, and Google, which already offers an organic chef and an on-site masseuse, are also signing up. So are white-shoe, Old Economy outfits like consulting firm McKinsey, Deutsche Bank, and Hughes Aircraft.

There are no hard numbers on how many companies have added meditation benefits, but the anecdotal evidence is mounting. And it's no surprise that more employers are seeking a new corporate balm. The National Institute for Occupational Safety & Health finds that stress-related ailments cost companies about $200 billion a ye increased absenteeism, tardiness, ar loss of talented workers. Between 7 90% of employee hospital visits are to stress. And job tension is directl to a lack of productivity and loss of petitive edge. "Stress is pretty muc No. 1 health problem in the workp says Eric Biskamp, co-founder of Life Seminars in Dallas, who has b teaching one-on-one meditation ski executives at Texas Instruments, theon, and Nortel Networks.

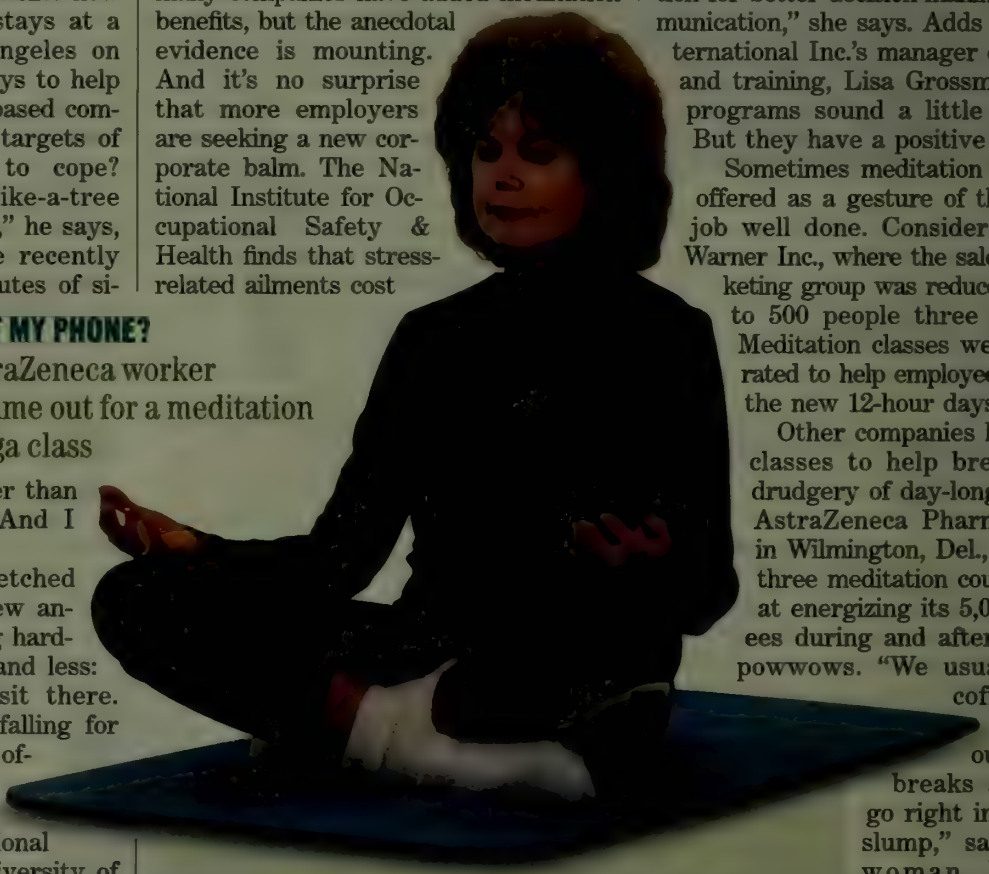
Meditation quiets mental chatte plains coach Tevis Trower of New Balance Integration Corp., which o ops meditation and yoga program large corporations. "It lays the fou tion for better decision-making and munication," she says. Adds Viacom ternational Inc.'s manager of wor and training, Lisa Grossman: "T programs sound a little out t But they have a positive impac

Sometimes meditation classe offered as a gesture of thanks job well done. Consider AOL Warner Inc., where the sales and keting group was reduced fro to 500 people three years Meditation classes were inc rated to help employees deal the new 12-hour days.

Other companies have a classes to help break up drudgery of day-long meet AstraZeneca Pharmaceut in Wilmington, Del., now o three meditation courses a at energizing its 5,000 em ees during and after mara powwows. "We usually h coffee an Danis our mee breaks and w go right into a s slump," says spo woman Lorra Ryan.

The icing for panies is that me tion programs cheap. "Everybod dealing with lim dollars," says Gr man. "It's impor to keep things g when times aren' good." So emplo can breathe easy: is one perk that likely to get axed.

By Mara Hovanes in New Y



IS THAT MY PHONE? An AstraZeneca worker takes time out for a meditation and yoga class

THE ENLIGHTENED OFFICE

Meditation is no longer just a practice of the prayer-bead & Birkenstock crew—now a number of corporations are offering it to their white-collar workers. Its benefits:

- **Alleviates lower back pain,** headaches, and arthritis—some of the most common employee health problems
- **Decreases absenteeism,** tardiness, and loss of talented workers
- **Increases brain-wave activity**—the better to create the Next Big Thing
- **Juices** intuitive decision-making
- **Optimizes concentration,** enabling workers to multitask more efficiently

WE USED TO DO EVERYTHING EXCEPT PAYROLL.

NOW, WE JUST DO EVERYTHING.

More than half of all *Fortune* 500 companies rely on Hewitt Associates' industry-leading thinking, process, and technology to dependably deliver a wide variety of HR services. And now, Hewitt is applying the same high standards to payroll services. Which means when it comes to maximizing your organization's talent investment, there's one company you can count on for, well, everything. For more information, visit our Web site at www.hewitt.com.

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IBM®

Kris Pederson, IBM practice leader, communications industry

Profitability thresholds and the feasibility of toast.

You push a button, you get toast. Easy. But only because you don't have to build the hydroelectric dam that furnishes the few watts it takes to make toast.

Now imagine that you are a telecom company, for example, looking hard at a lot of brilliant service offerings that defy feasibility because revenues just won't beat costs unless you sign up millions of customers. Which isn't likely. This is where on demand business comes in. Where the infeasible can become profitable because new thinking trumps old.

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Developments to Watch

EDITED BY ADAM ASTON

THE STUFF THAT BAD DREAMS ARE MADE OF

SLEEP DISORDERS CAN CAUSE more than just sluggishness. Some 20 million Americans experience breathing disruptions due to obstructive sleep apnea, a condition that can lead to heart disease, high blood pressure, and stroke. Others suffer from REM sleep behavior disorder, a terrifying condition that can cause them to walk, talk, or even pummel their bedmates as they act out their dreams.

Scientists at the University of Michigan say they have identified chemicals that may play a role in these disorders and could help steer researchers to new therapies. Studying brain scans and sleep patterns of patients suffering from a rare neurological disease that causes insomnia, researchers discovered that people who are deficient in brain cells that produce acetylcholine suffered the worst sleep apnea episodes. And patients with low levels of dopamine in their brains experienced the most violent episodes of REM sleep behavior disorder. Imbalances in both these chemicals have been implicated in ailments such as Alzheimer's and Parkinson's diseases.

SLEEP DISORDERS: *Chemicals may be a culprit*

Larger studies will be required to determine if the chemical imbalances actually cause the sleep disturbances. Still, says Dr. Sid Gilman, chair of the neurology department at the university's medical school, "this gives us a window into the basic science of some very debilitating disorders." *Arlene Weintraub*

A HEAD START IN TREATING MULTIPLE SCLEROSIS

IT'S TRICKY TO DIAGNOSE multiple sclerosis, a degenerative neurological disease that can lead to paralysis. Doctors often misinterpret early symptoms, such as tingling, blurred vision, and tremors. And even when MS is suspected, current tests involve repeated MRI scans over several months.

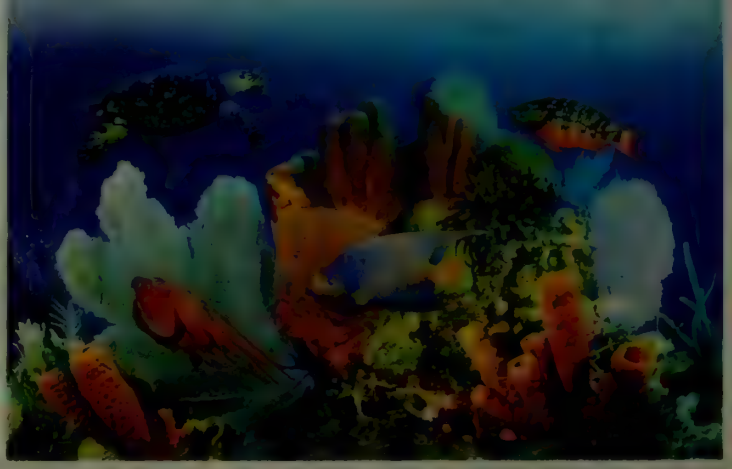
A blood test developed by researchers at Austria's University of Innsbruck takes just two days to process, costs about one-tenth as much as an MRI scan, and could be available within a year. The test identifies two types of antibodies that occur in people who develop full-blown MS. "The potential of the test is to evaluate whether a patient needs immediate treatment or not," says Thomas Berger, who led the study published in the July 10 issue of the *The New England Journal of Medicine*. In about 35% of new cases, early treatment prevents relapse, while reducing the severity of later attacks when they do occur. *Christina Passariello*

VANISHING ACT IN THE CARIBBEAN

CORAL REEFS ARE AMONG THE RICHEST, MOST DIVERSE concentrations of life on earth. Sadly, these delicate ecosystems are dying off at an alarming rate. One of the most comprehensive warnings of this trend comes from a group of researchers at Britain's University of East Anglia. It compiled data from studies covering 264 sites across the Caribbean and, for the first time, assessed overall damage throughout the region.

Their findings, published in the July 18 issue of *Science*, show that in the past three decades, the cover of live coral on Caribbean reefs has fallen by 80%—greater than the loss rate for tropical forests over the same period. When the organisms that create coral die off in an area, a menagerie of fish and other interdependent creatures soon disappear, leaving behind a lifeless, gray reef.

While the rate of loss slowed somewhat after peaking in the 1980s, the study shows that it has held steady in recent years. Now, as in the '80s, the chief culprits in the devastation of the reefs are fishing, pollution, and other factors related to human activity. ■



NEURAL STEM CELLS: NO FEAR OF REJECTION?

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Young says the dis
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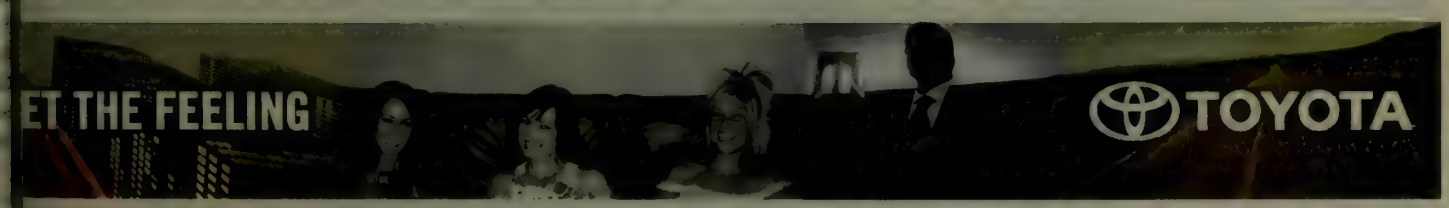
Stem Cells. *Catherine*



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MILITARY HARDWARE

SUPER SOLDIERS

New materials and technologies could boost the mobility and safety of U.S. troops

The U.S. Army wants to turn G.I. Joes and Janes into superheroes right out of Hollywood. In the 1987 film *Predator*, Arnold Schwarzenegger played an Army commando battling an alien in a suit that rendered it invisible. The film got mixed reviews, but the Army hopes its so-called Future Warrior outfit will be a smash on the battlefield. "With a uniform like *Predator*'s, our soldiers would really have a lopsided advantage," says Jean-Louis "Dutch" De Gay, a systems engineer at the Army's Soldier Systems Center in Natick, Mass.

The black battle garb planned for the late 2010s looks scary enough when can see it, but invisible soldiers w be a lot scarier. No joke. Scientist DuPont Co. are already hunting ways to manipulate light so sold could appear to disappear. And if doesn't pan out, EIC Laboratories In Norwood, Mass., is working on "e trochromic camouflage"—a chame fabric that would change colors inst ly to blend in with its surroundings

Research on such concealment m ods is classified. However, at the Institute for Soldier Nanotechnolo at Massachusetts Institute of Techno scientists are free to talk about the bat gear they're designing. And sold aren't the only ones they aim to h Their work also could help protect fighters, police officers, and other e gency responders—with self-ad istering tourniquets, lightweight armor, and artificial muscles.

President Charles M. Vest didn't wa "get tangled up in classified research he insisted that all developm spawned on campus be available t dustry as well as the military.

The MIT center, which opened in May, was launched with a $50 mil five-year grant from the Army. budget was doubled by matching f from MIT and a dozen industrial p ners, including Raytheon, Dow C ing, and DuPont. The companies si up to tap MIT's expertise in nanot nology—creating new materials and vices molecule by molecule, instea fabricating them from bulk mater Materials engineered with such ingr ents as carbon nanotubes can have p erties that are otherwise impossibl achieve. As a result, says De Gay, ence fiction is rapidly becoming r ty—and that could change forever way wars are fought."

One concept for "smart" body a would weave thin pads or even c from fibers that can sense the impa a bullet or shrapnel and automati stiffen, becoming even more impenetr than the cumbersome ceramic-plate mor troops wear now. Another m goal is cloth that eliminates the nee ungainly biochemical-warfare suits

WARRIOR OF THE FUTURE

Innovations that could show up on the battlefield during the next decade

ALL-SEEING SENSORS
Radar, night vision, and video cameras would probe behind walls and into the dark—and relay images to commanders

DISPLAY
Built into the visor, it would show text messages, map coordinates, and other tactical info

SUSTENANCE PACK
Air filtration system and drinking tube would enable soldiers to fight when under biochemical attack

BODY ARMOR
A cloth-like material would allow more flexibility than the current armor plates

ARTIFICIAL MUSCLE
External bone-and-muscle system would extend endurance and provide extra strength

BIO SENSORS
Next to the skin, they would track vital signs and relay data to medics

'SMART' FABRIC
Would sense and then seal out chemical or biological weapons, eliminating the need for a separate biowarfare suit

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stead, regular uniform fabric may sport nano-size umbrellas that open to seal the cloth's pores, making it impervious to airborn chemicals and pathogens.

In both cases, a key objective is to take a load off soldiers' backs. Today, they lug 60 pounds or more into battle, depending upon which weapon they carry, and the so-called marching load is almost twice as heavy. In five years, the Army wants to trim the combat load to 40 pounds, and then to 15 pounds with the Future Warrior outfit. MIT's Vest predicts that armored vests, which weigh 28 pounds now, will end up "at around eight pounds, maybe even five."

Artificial muscles that could enable soldiers to leap tall walls, if not buildings, are in the works, too. One candidate is made from polypyrrole. It flexes when jolted by electricity, then relaxes when the juice is turned off. So far, though, its reactions are much too slow.

Even with the best armor, wounds are inevitable. So when a soldier is hit in an arm or leg, special fibers in the uniform would constrict into a tourniquet. This will be a real life-saver, because half of all battlefeild deaths are due to massive blood loss before wounded soldiers can be treated. In addition, sensors would provide the soldier's vital signs and location to medics via radio. Until the Future Warrior garment is ready, soldiers will wear an adhesive chest patch fitted with sensors and a tiny radio. It's being developed by MIT partner CIMIT (Center for Integration of Medicine & Innovative Technology) in Cambridge, Mass.

To satisfy its industrial partners and avoid chewing up money needlessly, the new institute will be "run on a business model, with regular milestone reviews," says Edwin L. "Ned" Thomas, the MIT materials-science professor tapped as its head. It will have a staff of 40 MIT scientists from eight departments, plus 100-odd graduate students and visiting researchers from the Army and industry.

Thomas admits that some wish-list items may never materialize. But that's okay—the idea is to infuse army research with new thinking. So the Pentagon plans to announce, starting in August, more research centers at other universities, focused on such areas as biotechnology and detecting landmines. In the same spirit, to supplement its $1.2 billion research effort, the Army will funnel $25 million to small, innovative companies that probably never dreamed of getting a Pentagon contract. The fund's top priority? Finding better ways to generate and store power for the Army's high-tech gadgets. It's easy to see why: A brigade of 1,500 troops goes through 120 tons of batteries a year. And that's before they hit their invisibility buttons.

By Otis Port in Cambridge, Mass.

COMMENTARY

By Christopher Palmeri

TO REALLY BE A PLAYER, MATTEL NEEDS HOTTER TOYS

The Bratz pack has invaded the Gabriele house. The line of trendy dolls burst on the scene two years ago, offering girls a hipper alternative to that old standby, Barbie: Think Jennifer Lopez to Barbie's Reese Witherspoon. Joan Gabriele, a Hollywood (Fla.) mother of two, now has eight Bratz dolls in her home. Her daughters, ages 6 and 8, rarely touch their Barbies. "Barbie is pretty much a thing of the past," she says. "They like Bratz better."

That's bad news for Barbie's maker, Mattel Inc.—and for the three-year-old turnaround efforts of CEO Robert A. Eckert, the ex-president of Kraft Foods Inc. who replaced the embattled Jill E. Barad. The El Segundo (Calif.) toy giant counts on Barbie for about one-third of its revenues and more of its profits. But Mattel says U.S. Barbie sales declined 2% last year and 14% in this year's first quarter. The overall doll category, says market researcher NPD Group Inc., dropped only 3% in the quarter.

Give Eckert, 48, his due: He pulled Mattel out of its tailspin after its disastrous $3.8 billion acquisition of Learning Co. He got rid of the money-losing computer-game maker and slashed costs. His goal: to bring the stability of a consumer-products company to the hit-driven toymaker. And using such practices as computer-aided design to speed up product development and just-in-time inventory management, he succeeded.

But now it looks like Eckert is learning a valuable lesson: Mattel is selling toys, not soap or cornflakes. Good brand management goes only so far in a business that caters to children's whims. Like it or not, the key to success is launching innovative products and promoting the heck out of them. If you don't do it, your competitors will.

Eckert's strategy has been great for Mattel's bottom line. Profits last year, before special charges, were a healthy $455 million, and the stock has nearly doubled, to $20, since Eckert arrived in May, 2000. But top-line growth has sputtered. U.S. revenues, $3.4 billion in 2002, have declined marginally in the past few years. Total 2002 sales of $4.9 billion crept up from $4.6 billion i thanks to overseas expansion.

While Eckert continues to b the massive Barbie franchise t constructed, he now knows tha needs hot new toys. Recycling acters like *Sesame Street*'s Elm won't be enough. "We need to ter job on the top line," he say good news is, it's only spring t and we have a long season ahe

To that end, Eckert has be ambitious push. Between now Christmas, he hopes to launch toys, including dozens of Hot models and Flavas, a Bratz-lik posse with baggy jeans and se bling-bling. Originally, half of t toys weren't scheduled until 2

FIRST CAME BRATZ...

MAKER	MGA Entertainment
DEBUT	2001
NAMES	Yasmin, Sasha, Cloe, Jade, and Meygan
MOTTO	The girls with a passion for fashion
HER RIDE	Late-night stretch limo

should help boost sales. But it's ore important that Mattel prove espond to nimble upstarts as traditional big rivals like Hasbro er all, it took the company more ear to launch a competitor to tertainment's Bratz. My Scene lidn't hit stores until last Octo- has yet to make a dent in success. At its Santa Monica tore recently, Toy 'R' Us Inc. just a sliver of the shelf space cene that it did to Bratz. And ie dolls were being offered at 2 t's not really catching ground," n P. McGowan, toy industry an- Harris Nesbitt Gerard Inc.

Mattel will start tossing in a cell phone with 300 free minutes if you buy four of the $13.99 dolls. It also plans to add accessories and boy versions—Hudson, River, and Bryant.

Barbie isn't the only Mattel stalwart under attack. Its Fisher-Price unit, long the king of preschool, is losing sales to newcomer LeapFrog Enterprises Inc., whose electronic interactive books have captured 19% of the $2.9 billion preschool toy and electronic learning aid markets. Eckert is counting on a successful launch in August for PowerTouch, Mattel's version of LeapFrog's popular interactive book. PowerTouch is operated by pointing a finger at an image or a word, instead of the stylus used in LeapFrog's original products. That's key for younger kids. "It's much easier for her to use," says Christopher Coye, a Los Angeles-area parent whose 4-year-old tested a PowerTouch. Still, LeapFrog releases a finger-operated system in August, too.

Over the long term, Eckert puts at risk one of the strongest toy companies around if he can't instill innovation and rapid reaction in his much-tightened organization. To his credit, he is making it crystal clear that he doesn't want ideas to linger in the pipeline. When Matchbox brand managers mentioned this year that they had designed a toy firehouse that could be shipped with no assembly required, Eckert told them to get it out by fall. "Why wait?" he says. "If you've got it, sell it." And not a moment too soon: Sales of Mattel's Hot Wheels and Matchbox cars fell 6% in the first quarter, thanks to competition for boys' attention from action figures like Hasbro's resurgent G.I. Joe and Transformers.

The question is how much Eckert needs to tweak his model. He probably cut back too much, for instance, on marketing. In 1998, Mattel's advertising and promotional spending totaled $631 million, or 13.8% of sales. By last year, it had fallen to $552 million, or 11.2% of sales. Aggressive television marketing boosted sales of Hot Wheels cars in Spain last year, and a strong new campaign could help Mattel toys here.

Mattel won't live or die on every new toy it develops. But it can't just rely on Barbies, either. "Like they say in business school—no risk, no reward," says Isaac Larian, CEO of privately held MGA. He should know: He got the idea for Bratz after seeing his own kids run around in navel-baring tops and hip-huggers. As Eckert is finding out, sometimes the best ideas are right in front of you.

Palmeri covers toys from Los Angeles.

...THEN, MY SCENE BARBIE

MAKER	Mattel
DEBUT	2002
NAMES	Barbie, Madison, Chelsea, and Nolee
MOTTO	My city. My style. My scene.
HER RIDE	Vespa motorscooter

Data: MGA Entertainment, Mattel

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COMMENTARY

By Howard Gleckman

TAX-SHELTER CRACKDOWN: THEATER OR REALITY?

From the look of things, the Internal Revenue Service has declared war on the tax-shelter industry. The agency is forcing accountants, lawyers, and other promoters to reveal the names of their clients and details of complex tax schemes. And new Commissioner Mark W. Everson sounds like one tough cop: "The IRS will enforce the law...with particular vigor [against those] who enter into abusive shelters to game the system," he said at his installation ceremony on June 11.

Surely, the campaign has slowed an explosion of shelters. But there may be less to the effort than meets the eye. Despite a handful of high-profile cases, overall IRS enforcement is at its lowest level in a decade. And the agency rarely hits either promoters or their clients with tough penalties. Meanwhile, the Bush Administration has resisted congressional efforts to grant the IRS broad new authority to shut down financial transactions that have no purpose except to cut taxes. As a result, the IRS may be unable to root out the most sophisticated abuses. The agency is "well-intentioned," says Senate Finance Committee Chairman Charles E. Grassley (R-Iowa). "But they need to do more."

The stakes are huge. Outside experts estimate that shelters cost the Treasury at least $10 billion a year. And the Multistate Tax Commission said on July 15 that shelters are costing states one-quarter of their potential corporate tax revenue this year. But because shelters are so hard to identify, the IRS concedes it has no accurate estimate of their magnitude.

Until corporate malfeasance became a national scandal last year, the Administration showed little interest in shelters. Accountants, lawyers, investment bankers, and other promoters routinely ignored rules that required them to register deals. In January, 2001, the Bush team opened the door to new shelters when it declined to appeal a court ruling in a case against Rite Aid Corp. that let parent corporations and their subsidiaries take deductions for the same expenses. And during Bush's first 14 months in office, Treasury barred only one specific shelter—vs. more than a dozen that were blocked in 1999-2000.

Treasury began to get religion after Enron Corp.'s collapse. The Administration, which had close ties to the energy giant's top execs, didn't want to look as if it were protecting corporate tax cheats. And the intense Treasury probe of terrorist money-laundering kept stumbling onto offshore bank accounts set up to shelter the incomes of wealthy Americans. Congress, which bashed the IRS through the late 199(for abusing taxpayers, suddenly beg demanding a crackdown on tax frau(

So the IRS reversed course. In Ju 2002, it began demanding customer formation from promoters such as a countants Ernst & Young and KPMG. On June 20, 2003, the agency sued t force Dallas law firm Jenkens & Gilchrist to name its shelter clients.

But while new Commissioner Eve son, a Texas businessman who's a newcomer to the tax world, promise

Mixed Messages On Shelter Abuse

The Internal Revenue Service has launched a high-visibility attack on tax shelters. But experts don't think it will put much of a dent in the trade.

WHAT THE ADMINISTRATION IS DOING:

■ **Identifying abusive transactions** The IRS has listed more than two dozen kinds of deals it says are abusive. It's requiring both companies and individuals to tell the IRS if they have taken advantage of these deals.

■ **Cracking down on shelter promoters** Accountants, law firms, bankers, and others who market tax shelters must provide the IRS a list of the clients who use them. The IRS is taking a Dallas law firm to court to enforce the rule.

WHAT IT NEEDS TO DO:

■ **Beef up penalties** Promoters and taxpayers who ignore disclosure rules are rarely assessed fines. Congress needs to give the IRS the power to impose stiff penalties and to bar lawy who work on abusive deals from practicing tax law.

■ **Broaden legal standards** Many shelters fail the smell test but are not illegal. The Bush Administration has opposed a new law that bars deals tha have no business purpose other than t avoid tax.

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to make life tougher for shelter-lovers, he'll have a tough time putting much of a dent in the trade. Why? For one thing, the IRS needs more agents. According to a Syracuse University analysis, in 2002 the IRS had 20% fewer revenue agents than it had a decade earlier. It audited just 2.1 returns per thousand of partnerships and other entities that pass profits through to shareholders, where much sheltering occurs. That's down from 5.1 per thousand in 1993. The number of civil fraud penalties imposed fell from 555 to 159, and federal tax prosecutions fell from 1,011 to 490. Says Stanford University law professor Joseph Bankman: "The IRS is hopelessly outgunned."

The agency also lacks the authority to impose tough penalties on promoters and taxpayers—a business' maximum penalty is only 20% of the amount it understates its tax. That's way too low. Corporations often negotiate down their tax liability in disputed transactions. Thus, regardless of the penalty, they are often better off cheating on their taxes, even if they get caught. Doubling penalties, to 40%, and making them nonnegotiable would be a big disincentive to companies that are thinking about playing the audit lottery.

But many experts say the most effective addition to the government's arsenal would be one Treasury and the IRS don't want: a law that bars deals unless they have a business purpose beyond just avoiding tax. Grassley is developing legislation that would put the burden on companies to prove that their deals meet this standard—a development that would make it much harder for pricey lawyers to game the rules. But Assistant Treasury Secretary for Tax Policy Pamela F. Olson argues that such a law wouldn't stop sleazy deals, adding: "You're going to hurt businesses trying to carry on legitimate transactions."

The target isn't legitimate deals, just over-the-top tax-avoidance schemes. The IRS deserves credit for cracking down on some promoters. But if the Bush Administration and Congress don't get more aggressive, shelter builders will still find many ways to help clients dodge Uncle Sam.

Gleckman covers taxes from Washington.

Entertainment

TELEVISION

YOUNG MAN, YOUR COUCH IS CALLING

Spike TV tries to reach an elusive–and valuable–audien

Cable executives have made a mad dash over the past several years to zero in on niche TV audiences, from fly fishermen to 1970s game show fanatics. Women have gotten tons of attention, too, with special channels like Lifetime, Oxygen, and WE. But the programmers missed one group along the way: young men.

Now it's the guys' turn. Later this summer, TNN will relaunch as Spike TV, "The First Network for Men," and its arrival could signal a new wave of programming aimed at 18-to-34-year-old males. Jumping into the fray with TV projects are red-hot men's magazines, like *Maxim* and *Men's Health*. Advertisers, too, are rushing in to woo men in their free-spending years. "It's been women three, men nothing," says Albie Hecht, president of Spike TV, part of media giant Viacom Inc. "We want to be a real home base for [young men], from fashion to finance."

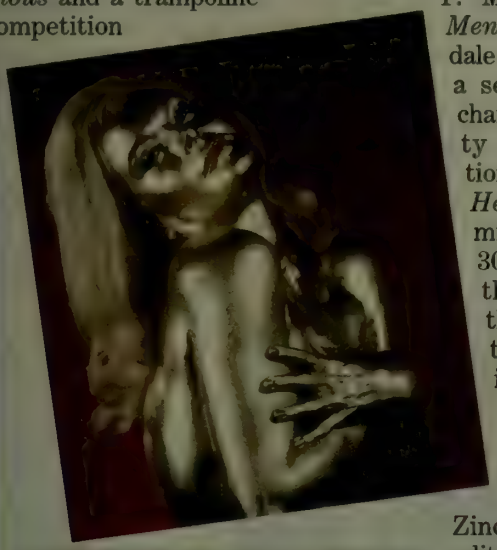
Of course, men haven't been ignored as a TV audience. Certainly, pro sports broadcasts and channels like ESPN, Comedy Central, and Fox's new Fuel, which focuses on extreme sports, draw plenty of guys. But few media companies have dedicated themselves to aggregating the young male audience, which is hard to capture because of the plethora of other entertainment choices, from the Net to video games. What's more, it turns out that men 18 to 34 are the smallest audience watching TV in prime time behind teenagers, according to Nielsen Media Research. When young men were asked where they first hear about products they are likely to buy, only 51% cited TV, vs. 70% of young women, according to the Television Bureau of Advertising, a trade group for local broadcasters.

The new men's programming could be the catalyst to close that gap, say media buyers. "This is a very elusive audience. Since so many young guys are multitasking at night, with computers, games, and TV at the same time, it makes them very hard to pin down," says Andy Donchin, director of national broadcast at media buying firm C USA. "If a channel can lock in this centrated audience, I applaud them

Though men are easily distra from the tube, Spike, which will reac million cable and satellite homes thr TNN's old distribution, says it's ho its programs will turn them all couch potatoes. While a lawsuit b rector Spike Lee, now resolved, has up the channel's official name cha

(CLOCKWISE FROM LEFT) PHOTOGRAPHS BY SPIKE TV, LOOMIS DEAN/MPTV, PATRICK ECCLESINE/SPIKE TV

ıy of its shows are already on the air, ix of titillation, extreme sports, pro stling, and trusty reruns (think *Mi- Vice*, CSI, and *Star Trek: The Next eration*). As part of a slate of adult oons, *Stripperella* features the voice 'amela Anderson as a woman who's xotic dancer by day and a superhero ight. *Gary the Rat* features actor ey Grammer's voice as a sleazy New k lawyer. There's also a gotcha game v called *Oblivious* and a trampoline basketball competition



BOYS' NIGHT IN: *Gary the Rat*, a *Goldfinger* Bond girl, and *SlamBall* are standard Spike TV fare

l *SlamBall*. And lots of Bond, s Bond.

is TV just borrowing the success- raternity-friendly "laddie" maga- formula? Absolutely not, says t: "You can't just give men beer babes." Spike will also feature live tes from CBS MarketWatch (also of Viacom), lifestyle tips from s *Health* magazine, and shows on gadgets from *Stuff* magazine. The channel has also announced a partnership with the Black Filmmaker Foundation to provide a platform for up-and-coming Asian, Latino, and African-American directors.

If Spike proves a success, more and more TV execs will likely be turning to magazines, forming links that could benefit both. "Can you imagine 10 years ago a broadcast network looking to a magazine for substance?" says Steven P. Murphy, president of *Men's Health* parent Rodale Inc., who is pondering a separate *Men's Health* channel. "That's the beauty of cable's segmentation." Ad pages at *Men's Health*, with about 10 million readers, rose 30% in the first half of this year, vs. 1.8% for the industry. "Men 18 to 34 are enormously influential consumers who advertisers are increasingly determined to connect with," says David Zinczenko, the monthly's editor-in-chief. "Historically, few venues have been able to reach them."

That helps explain why 38 new advertisers have flocked to the transitioning TNN this year, accounting for $40 million in additional revenues, says Hecht. "This is the audience we need to reach," says Debbie Myers, vice-president of media services at Taco Bell. "Heavy fast-food users tend to be younger and male." Taco Bell now spends nearly as much advertising on Spike as it does on MTV and ESPN, and even does product placements on shows like *Oblivious*. "We like that the channel is a little bit edgier," adds Myers.

Edgy is one way to describe it. Bawdy might be another. A favorite character on the channel could be Bluto, the beer-swilling, food-fighting character portrayed by John Belushi in *National Lampoon's Animal House*. To commemorate the movie's 25th anniversary, Spike plans to air a making-of documentary on Aug. 24, *Go Inside: Animal House*. What better way to initiate Spike than with a wild night at the frat house.

By Tom Lowry in New York

TESTOSTERONE TELEVISION

Cable channels have doted on women for years, but now a new wave of programming and channels is aiming to grab the young male audience. Here are some of the new and upcoming players:

GQ

The Conde Nast monthly magazine's annual "GQ Men of the Year" awards will be broadcast on Spike TV this year.

MAXIM

The so-called laddie magazine is developing more TV projects. It has partnered with the NFL, and on NBC, it produced the *Maxim Hot 100* show, ranking up-and-coming women in entertainment.

MEN'S HEALTH

The magazine will offer Men's Health Minutes with lifestyle tips on Spike TV. It's also doing health programming for ABC's *20/20* and *Good Morning America*.

NFL CHANNEL

New NFL-operated station will launch in November with programming pitched at young football fans.

SPIKE TV

Formerly TNN, Spike is billing itself as the first network for men, with spy movies, extreme-sports shows, adult-themed cartoons, *Star Trek* and *CSI* reruns, and, of course, pro wrestling.

STUFF

This laddie mag will offer A Guy and His Stuff, focusing on gadgets, to be wrapped around movies on Spike TV.

Data: *BusinessWeek*

COMMENTARY

By Spencer E. Ante

HAVE WEB SITE, WILL INVESTIGATE

It was early April, war had just broken out in southern Iraq, and freelance journalist Christopher Allbritton was trying to get into the country. The borders of Iran and Syria were closed. So Allbritton spent $3,000 for a Kurdish guide to take him over the fortified and mountainous Turkish border into the land of Saddam Hussein. Thirty-six grueling hours later, he stumbled into the country. He then spent three weeks reporting from Iraq, breaking news on the fall of Tikrit and highlighting the "Yugoslavia-style" ethnic tensions between Kurds, Arabs, Turkomen, and Assyrians.

Allbritton didn't have a juicy contract with *The Washington Post* or CNN. Rather, his trip was funded by 320 people who donated $14,334 through his Web site, Back-to-Iraq.com. Months before the conflict began, the former Associated Press reporter posted a notice on his site: He wanted to cover the war and asked for readers' financial support for "independent journalism." As the cash rolled in, Allbritton hit the road with his laptop computer, filing via a satellite phone or Internet café. Donors were put on a premium e-mail list, so they received stories early and got extra reports and pictures. They also passed along story ideas and occasionally berated him for overheated metaphors. "Readers were my editors," he says.

Is this the future of journalism? *The New York Times* may have nothing to worry about, but Allbritton's story hints at a new business model that could remake the lesser tiers of the media world. Call it pay-to-read journalism. Reporters, individually or in groups, could use the Net to raise money directly from readers interested in specific stories or journalistic styles. That could be independent journalism, in the spirit of the old *Village Voice*, or withering cultural criticism, a la *The Baffler*. Instead of aiming for the mass market, journalists have a way to target an audience of thousands, more easily pursuing stories that lie off the beaten path. "The good news is, there's more information," says Charles Lewis, founder of the Center for Public Integrity, a nonprofit that raises money for public-service journalism. "A talented young journalist can do great journalism. And that's a great thing."

ALLBRITTON IN IRAQ: Readers funded his trip

Although no one tracks the number of pay-to-read Web sites, there are probably a few dozen today. Like many successful Net technologies, reader-subsidized publishing is a grassroots phenomenon. Consider freelancer David Appell, a physics PhD who has written for *Nature*. After seeing Back-to-Iraq.com, he asked the public to donate $20 apiece to fund his investigation of the politics of the sugar industry. So far, he has raised $425. "I thought I would raise $50," says Appell. Subscribers should receive the story in a week or so.

Ultimately, pay-to-read journalism may have its greatest impact overseas, in countries that are more starved for information. The best example is OhmyNews.com, an online publication in South Korea that generates 80% of its news from more than 25,000 citizen-reporters who are paid depending on how a story is ranked by editors. The barely profitable site has been widely credited with helping elect the country's new president, Roh Moo Hyun, formerly a little-known human rights attorney. OhmyNews.com gets 8% of its $1.7 million in revenues from donations.

Allbritton and others are building on a flourishing Net trend: Web logs, or blogs. These are do-it-yourself sites where writers publish diaristic articles that anyone can read, typically for free. Now, some entrepreneurs see a future in pooling the work of bloggers and charging for it. The Blogging Network, a site started this January by ex-dot-commer Mihail S. Lari, charges readers $5.95 a month for articles on topics such as business and religion. Lari says he has raised about $40,000 to be distributed among the most popular bloggers.

True, pay-to-read journalism won't replace the *Times*. But it offers an increasingly powerful megaphone for the little guy.

Ante, who covers technology, is looking for a few good blogs to fund.

PAY-TO-READ JOURNALISM

Recently, a new business model has emerged in which readers fund Web-based indie journalism. Here are some examples:

PROJECTS Freelance journalists are pitching projects to readers. Former AP reporter Chris Allbritton covered the Iraq War after he raised more than $14,000 through donations.

PEOPLE Some high-profile bloggers have raised money to support their writings. The most successful, former *New Republic* editor Andrew Sullivan, says he raised $100,000 via donations.

NETWORKS Networks sprouting up in which readers pay a monthly fee to read stories from a passel of writers. One, the Blogging Network, says it has raised $40,000 from charging $5.95 a month.

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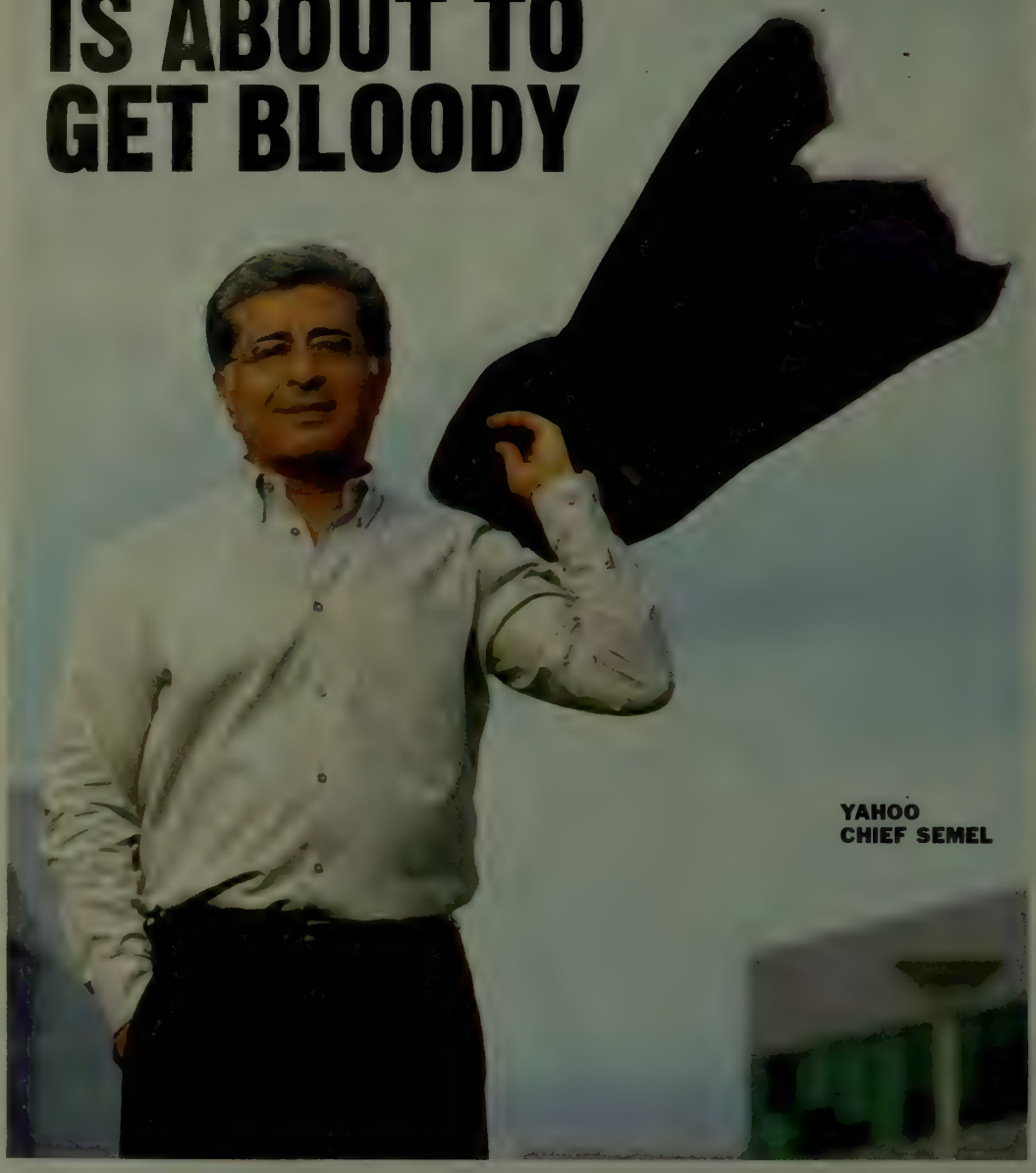

YAHOO CHIEF SEMEL

Yahoo! is spending like crazy to try to grab back business it has been handing Google for years

Three years ago, Yahoo! Inc. and the other leading Internet portals largely wrote off the search business. Spiffing up the way Web surfers plug words into a search engine to navigate around the Net seemed like a waste of time and money. So they put the brakes on developing their own search expertise and licensed technology from small fry like Google Inc. Big mistake: The search business boomed, and Google reaped the benefits. Consumers flocked to its site—and thousands of advertisers quickly followed.

Now, Yahoo is out to take back some of the thunder it so unwittingly ceded. On July 14, the Net kingpin agreed to dole out $1.6 billion for Overture Services, Google's main competitor. The deal gives Yahoo better search technology and, even more important, a stronger position in "paid search," a fast-growing segment of the online ad market in which advertisers pay to be listed in Web search results. Overture is the top player in that market, raking in an estimated $1 billion this year by auctioning placement in search results t vertisers and then distributing rankings on the sites of par such as Microsoft Corp.'s MSN Yahoo. "This assures a great ri between Yahoo and Google," Anthony Valencia, an analyst a Group Inc., which owns shar both Yahoo and Overture.

They're rivals with very c ent strategies for dominating Net. Nine-year-old Yahoo built is still the most popular spot o Web, with 121 million visito May, according to Nielsen//Ne ings Inc. It did this by creat self-contained digital world pa with a smorgasbord of services users can linger over, from e-m online shopping malls. Its reve which are expected to rise 35% year, to $1.3 billion, are well d sified, coming from banner ads search, subscriptions for ser such as personals, and a fast-g ing broadband partnership wit Communications. Google, wit elegantly simple site that c nothing but search, has upende traditional notion of what it tak lure a large, loyal following o In just a few years, this ba techies led by CEO Eric Sch have created the fourth-most ular site on the Web, with 83 m visitors in May. It will pull estimated $700 million in reve this year—all from paid search licensing of its search technolo

But the Overture deal may Yahoo the means to keep its over the fast-rising newcomer hoo now has search services match Google's offerings, and focus on using its unique ad tages to best Google in ways search-only service can't match example, Yahoo can offer busin bundled packages of banner paid search, online yellow-pages list and even the hosting of Net reta sites. "The fact that Yahoo has al components under one roof gives leg up. Yahoo can be all things to a vertisers, a one-stop shop," says P Growth Equities Inc. analyst Dere Brown. That should help Yahoo r tain the top spot in what's shaping be a three-horse race, with Google MSN, for the attention of advertisers consumers online.

The Overture deal comes not a m too soon. Since Yahoo started u Google's search technology on its si 2000, Google's share of searches jum from 1% to 38% this year. Over the

iod, Yahoo has seen its share slip n 49% to 32%, according to analytics WebSide Story. Overseas, Google s even stronger. In the past year, gle's traffic has soared past Yahoo's all traffic in numerous key markets, nding France and Britain, according Nielsen//NetRatings.

will be tough to beat gle at search, but now oo has a better chance olding its ground. Four ths ago, it bought ch engine Inktomi o. to bolster its position raditional search, where lts are based on mathtical algorithms, not on much advertisers pay. rture gives Yahoo more itional search engine nology and a top-notch -search business. Over- has a network of 0 advertisers, just shy oogle's 100,000. That's cal because the paidch market is projected nore than double over next three years, to $5.4 billion, mak- p 60% of the U.S. online advertising ket, according to Pacific Growth Eqs. "Yahoo now owns all the crucial ents of an end-to-end search offer- says Yahoo CEO Terry S. Semel. emel & Co. will quickly try to wring more benefits out of Overture. Yacould woo some of the 88,000 Over- advertisers into signing up for Ya- other forms of advertising, such as er ads. And it should be able to ert some of its own 300,000 smallness customers into paid-search adsers. "This may give us more lever- across the entire Yahoo al," says Eric Opel, manager nline advertising at Gatecom, which buys search ads Google and Overture.

eyond that, Yahoo hopes to ribute paid-search ads into es Google can't. Unlike le, Yahoo develops much of wn content, from a careers to a travel property. Instead mply displaying paid-search when users type in a search, o plans to showcase these s users peruse the broader o site. For instance, a visitor ng Yahoo's Caribbean travel might see a paid-search ad Club Med.

hoo also may have an edge Google in placing paid-search nto content from other companies, such as newspaper articles. Google's approach is almost entirely technology-based, scanning content and automatically placing ads with virtually no human intervention. That can lead to trouble. On July 1, a gruesome *New York Post* article about hacked-off body parts found in a deserted suitcase included three Google links to online luggage shops. Overture has a staff of 100 editors who screen out articles that may be inappropriate for advertisers. Google declined to comment for this article.

GOOGLE CEO SCHMIDT
Since its Yahoo deal in 2000, Google's share of Web search has jumped from 1% to 38%

Still, all of this promise is based on one challenging assumption: Yahoo must skillfully integrate its newly acquired companies. While analysts have long speculated that Yahoo would purchase Overture, the timing could be problematic. Many analysts expected Yahoo to wait until it had fully digested its March acquisition of Inktomi, and Overture had integrated the search units it acquired from AltaVista and Fast Search & Transfer earlier this year.

Overture represents Yahoo's largest acquisition since Semel took over in 2001 and the third-biggest in the company's history. Overture, meanwhile, already is struggling to work out the kinks in its two acquisitions, analysts say. It cited unexpectedly high infrastructure costs in a recent warning that 2003 earnings would fall far short of expectations. Now, Yahoo must somehow solve these problems and weave a razor-sharp search organization out of business units scattered from southern California to Norway. "Strategically, there are a ton of positives here, but I'm surprised about the timing," says Pacific Growth's Brown.

Furthermore, making the acquisition pay off is no sure thing. As the behind-the-scenes provider of paid-search services to many Web sites, Overture occupied a neutral position. Now that that neutrality is gone, Yahoo rivals could jump ship. Most at risk is MSN, which accounts for about one-third of Overture's revenues. If that happens, Yahoo would end up paying about 60 times Overture's estimated 2004 earnings for the company. Even if MSN stays onboard, the price tag is still about 40 times next year's earnings. "That's fairly expensive," says Troy Mastin, an analyst at William Blair & Co. "I'm not sure it was a wise move."

Yahoo defends the price and timing of the deal. Semel argues that his merger-and-acquisition track record at Yahoo is solid and that the three previously acquired companies under his watch are right on schedule. In addition, Yahoo Chief Financial Officer Susan L. Decker insists the Overture acquisition will be at least at breakeven in its first year. Moreover, MSN's future as an Overture customer is not sealed. Although MSN can get out of its current Overture relationship if it wants to, Semel anticipates retaining the MSN business. MSN says the company has not made any decisions regarding its Overture deal.

Yahoo's bid to strengthen its search business won't be easy. But if the portal can pull it off, the price for additional firepower in this arms race could end up looking very affordable.

By Ben Elgin in San Mateo, Calif., and Arlene Weintraub in Los Angeles

YAHOO! AND GOOGLE FACE OFF

With the $1.6 billion acquisition of Overture, Yahoo is aiming to chip away at Google's dominance in the search business. Here's how the two stack up:

SEARCH AUDIENCE

About 50% more people visit Yahoo's Web site than Google.com. But when it comes to search, 38% of users online head for Google, vs. 32% for Yahoo, estimates WebSideStory.

Advantage: Google

TECH APPEAL

Google's unique technology provided a quantum leap in search quality. Now, other search engines, including Yahoo's recently acquired Inktomi, are closing the gap. Still, Google is in the lead.

Advantage: Google

CLOUT WITH ADVERTISERS

Although Google has slightly more advertisers who pay for placement amid search results, Yahoo has stronger relationships with small businesses because of its broader ad offerings.

Advantage: YAHOO!

STRATEGIES

THINKING OUTSIDE THE CEREAL BOX

General Mills' far-flung search for efficiency ideas

As the economy has unraveled over the past three years, managers desperate to prop up profits have been beating the bushes for new ways to cut costs. Few, however, have wandered further afield in pursuit of smart ideas than General Mills Inc. chief technical officer Randy G. Darcy. He has participated in predawn raids with a U.S. Marshals Service SWAT team, hung out with a NASCAR pit crew, and watched Air Force mechanics fix Stealth bombers. Darcy's unlikely goal: to make his operation "the best supply chain in the world."

It's more than just a theoretical ambition. CEO Stephen W. Sanger has given Darcy an epic challenge: cut $1 billion out of General Mills' supply chain in 10 years. By getting the company into fighting trim, Sanger hopes he'll be able to dig out from under a staggering $8.9 billion in debt from his $10.1 billion acquisition of Pillsbury from Diageo PLC in 2001. That's no small task for a company with $10.5 billion in sales that has already cut hundreds of millions of dollars over the last decade.

Slashing costs is just one of many challenges General Mills faces. It needs to regain market share that it ceded to archrival Kellogg Co., which became the No.1 U.S. cereal maker last year. And it's fighting off fierce competition from Campbell Soup Co. and ConAgra Foods Inc. in canned soups and ready-to-eat meals. Says Sanger: "We can't get by doing what we did yesterday."

Darcy is confident that he can save $800 million of the $1 billion target by adapting lessons in efficiency learned elsewhere. But money-saving ideas from pit crews and SWAT teams? Don't laugh: He has already made considerable progress. Darcy targets groups that routinely take performance to the extreme, studying them for efficiency secrets that might benefit General Mills—either by applying those secrets directly or by jolting employees into thinking of new ways of doing their jobs. By observing how a NASCAR pit crew was able to work with blinding speed simply through better organization, General Mills was able to cut the time it took workers to change a production line at a Lodi (Calif.) factory from one Betty Crocker product to another from 4.5 hours to just 12 minutes. And by watching the way that Stealth bomber pilots and maintenance crews cooperated, the company was able to improve its own teamwork, helping to cut cereal production costs by 25% at a plant in Buffalo.

Such gains, while impressive, may represent only a fraction of what's possible for General Mills, the maker of Cheerios cereal, Betty Crocker cake mixes, and Hamburger Helper. Anand Sharma, the CEO of TBM Consulting Group Inc. in Durham, N.C., who specializes in efficiency, says the company should be able to triple its cost-cut goals—aiming for annual producti improvements of 15% and profit gair an additional 4% by aggressively ap ing what it learns. Moreover, exp say that seeking inspiration outside industry, as General Mills is doing the only way to leapfrog ahead of ri "Given how efficient many organizat have become, the next big idea w come from internal thinking," Ravin Jesuthasan, principal at Tow Perrin's reward and performance r agement consulting practice in Ch go. "It has got to come from rev tionary, outside-the-box thinking."

But even with all of General M efforts to borrow management id from the unlikeliest of places, reac the $1 billion savings goal won't easy. Companies like General M which has been cutting costs for ye may find future efficiency gains ha to come by.

BORROWING FROM THE BEST

STEALTH BOMBE and maintenanc gave the compa on IMPROVING T hiring, and trai cereal plant in I That helped cut production costs per case of cere

General Mills workers studied how a PIT CREW changes race-car tires. The EFFICIENCY TECHNIQUES they learned helped cut, from 4.5 hours to only 12 minutes, the time it takes a Betty Crocker factory line to swap from one product to another.

And while Darcy believes the b fits from his excursions outside the real biz are real, some are impossibl measure. For example, the SWAT te cooperative approach to nabbing f tives inspired General Mills to rep separate performance goals for e neering, purchasing, and produc with a single set of goals for all partments, eliminating the incentive one department to cut corners at

er's expense. Darcy cites a purchas- manager who met cost-cutting goals er the old system by buying thinner ons—even though they jammed up production lines, raising manufac- ng costs. Gross margins have im- ved in the four years since the new ntives were implemented—from to 47%—but it's unclear how much ne improvement can be attributed to change.

inally, not all the efficiency lessons Darcy brings back from the field be adapted throughout General s. While the company was able to the NASCAR lessons to transform Betty Crocker plant—by replacing dard bolts with those requiring a quarter turn and stocking tool- s with the specific gear needed to ch product lines—efforts to dupli- much of that success elsewhere d because many plant functions e unique.

arcy isn't giving up, though. Lately, been working with Erik Weihen- er, a blind mountaineer who has d the seven greatest summits. The to understand his method for as- bling expedition teams based on

s are to meet with blind er ERIK WEIHENMAYER, who ven major summits. By learning embles successful expedition y hope to gain INSIGHT INTO P and teamwork.

nality traits, instead of climbing insights that Darcy says will prove al to the success of the Pillsbury ration. "The only way to cross a er is on a rope to which your en- team is tied," says Weihenmayer. either all plunge together or suc- together." Darcy and his team are ng they won't be falling into the any time soon.

By Pallavi Gogoi in Minneapolis

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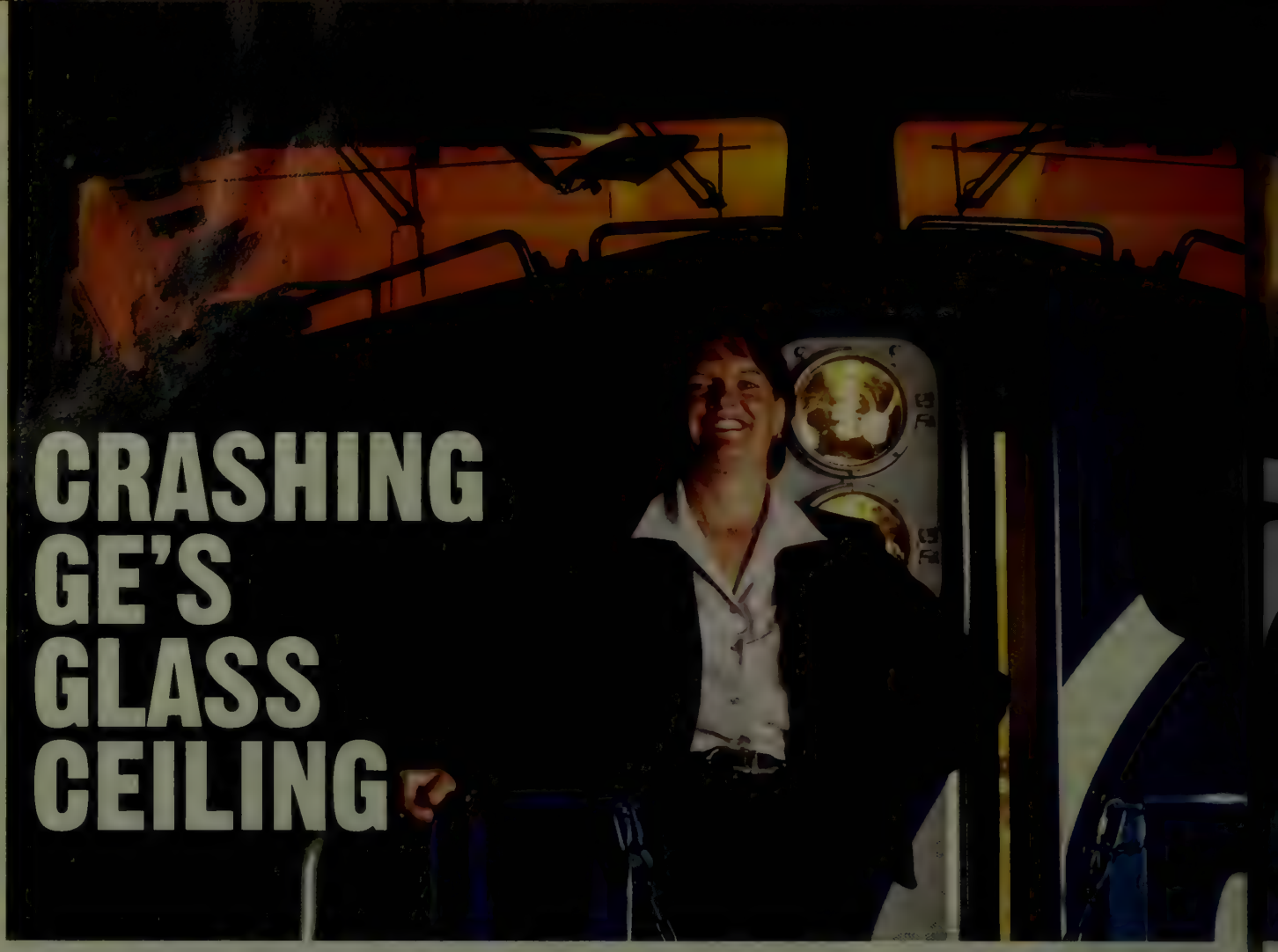


CRASHING GE'S GLASS CEILING

Charlene Begley is among a generation of female execs who may find room at the top

Charlene T. Begley was speaking at a women's networking conference at General Electric Co. in 1999 when she first admitted to heresy: She told the group she doesn't work weekends. Ever. One skeptical colleague told her to confess the truth: After all, this was GE, a bastion of back-slapping overachievers who idolized the workaholic John F. Welch and were expected to move to places like Erie, Pa., on a moment's notice to advance their careers. "No one believed me," says Begley, who argued she can get her work done during the week.

Guess so. Four years later, the 36-year-old mother of three is president and CEO of GE Transportation Systems—the first woman ever to lead a major GE unit. She may be living in Erie and taking on some of the biggest challenges facing the $132 billion company, but she still doesn't work weekends.

That said, a lot has changed at her company in that time. Welch, who had a mediocre record on diversity and used to sneer openly at the idea of "work-life balance," has retired. In his place is Jeffrey R. Immelt, 47, who came of age in an era of feminism and has loudly pledged to make GE a model of diversity, especially in the senior ranks. On July 15, he appointed communications veteran Beth Comstock to a new position as chief marketing officer.

Of GE's top 173 officers, 13.3% are now women. That's better than the 4.5% of six years ago, but still less than the 15.7% average at America's 500 largest companies, according to a study last year by Catalyst Inc., which tracks women in business. Immelt, who asked Catalyst to advise the company three years ago and joined its board in late 2001, says Begley is just the most prominent of numerous female executives who are rising fast at GE. "We've got an excellent pipeline," he says. "But the only way I look at success in this area is the percentage of women and minorities in leadership jobs."

Begley, who says she never encountered any sexism at the company en route to the top, is classic GE: impatient, smart, and driven to succeed. She even plays golf. Growing up with four sisters, one adopted brother, and a constant stream of foster babies in Durham, Conn., Begley was always trying to distinguish herself. "I took a class with her once, and it was humiliating," says her older sister, Debra Turcotte. [illegible] receiving a business degree in 1988 [illegible] the University of Vermont—chose[illegible] cause it offered her the most schola[illegible] money—Begley fought to get into t[illegible] nancial management program at [illegible] friend's father had convinced her it [illegible] "the best company in the world."

She won the job and was sent str[illegible] to the bleak industrial city of Erie, w[illegible] she handled forecasting, accounting [illegible] a range of other financial activiti[illegible] locomotive unit GE Transportation [illegible] tems, for a salary of $26,500. There [illegible] met a young mechanical engineer, [illegible] Begley. When he left for Arizona [illegible] then North Carolina to pursue grad[illegible] studies in engineering, they conti[illegible] to see each other two weekends a m[illegible] By 1990 she had joined the grueling [illegible] prestigious corporate audit staff; [illegible] married three years later. Her firs[illegible] signment: improve the methods for s[illegible] ing materials at GE Appliance[illegible] Louisville. "I had no clue what I wa[illegible] ing," says Begley, who recalls tears[illegible] treme fatigue, and angst-ridden p[illegible] calls to Chris about how terribly [illegible] was handling the job. In fact, she w[illegible] management award after she comp[illegible] the four-month project.

That put Begley on the fast t[illegible] which at GE means she has worke[illegible] 20 locations worldwide over 15 y[illegible]

DRIVER'S SEAT

Begley, CEO of Transportation Systems, is the first woman to lead a major GE unit

"She is being tracked through the chairs that allowed other stars to rise," notes Peter Crist, an independent executive recruiter. The stints ranged from vice-president of operations for GE Capital Mortgage Services, a job that required her to lay off nearly three-quarters of the staff shortly after she returned from a six-week maternity leave, to heading the audit staff and becoming, at 32, the gest corporate officer in GE history. at job, she nixed the practice of atory meetings to discuss diversity s, saying it felt forced. Instead, ried to make sure that people got r mentoring and assignments. She ed, for example, that Japanese and se employees tended to be quiet. e let them do initial audits in their countries to build confidence and to make sure "we weren't evalu- them on a style difference."

someone who admits that she of- idn't feel ready for the next pro- n, Begley understands the value great mentor. Her biggest champi- David L. Calhoun, now presi- and CEO of GE Aircraft En-

gines. He recognized her talent when she worked for him on the audit staff, wooed her back to Erie to take charge of Welch's baby—the Six Sigma quality initiative—when he ran GE Transportation Systems, and then asked her to become its chief financial officer, despite what he calls a "skinny" background in finance. "She looked like a person with massive potential who just needed the right assignments," says Calhoun.

Such encouragement can be critical, especially in big companies, but women sometimes complain they don't get much of it. Like many men who advance to top jobs, Begley always has been quick to seek out feedback and support. Linda Micowski, her eighth-grade teacher, recalls a girl who would linger after class to discuss everything from boys to her plan to be in the top 10 of her graduating high school class. Micowski, a mother figure who has also become one of Begley's best friends, even helped her buy a power suit for her first GE job.

GE has tried to institutionalize that sort of assistance through its 16,000-member Women's Network. Begley grudgingly helped start the group seven years ago when more than a dozen top female employees were summoned to discuss with Welch GE's problems in retaining women. "I was initially against the network," says Begley. "I want no part of being treated differently because I'm a woman." She has since come to see its value in networking, mentoring, and promoting alternate routes to the top. Susan Peters, vice-president of executive development and another founder of the network, notes that GE's tradition of moving executives around the world on short assignments puts women, in particular, in a difficult bind since their spouses often have careers of their own to think about. And it doesn't help that many of GE's prime jobs are in out-of-the-way cities. Says Peters: "It's not that easy to be available to move to unique locations."

Begley's husband knows all too well how unique those locations can be. During the course of their marriage, he has lived in such spots as Easton, Conn.; Keswick, Va.; and Brasschaat, Belgium. Although he has put his dream of becoming a professor on hold, he notes that Charlene's financial success has "definitely given me a lot of freedom" to pick and choose projects as an engineering consultant. But the constant moves are still a strain. Their eldest daughter, Jenny, 9, cried into her pillow when they told her they had to leave Charlottesville, Va., for Erie. Even having her mom produce a list of local horse stables where she could ride did little to console her. Daughter Jordan, 6, wasn't too thrilled either. And Begley says that two-year-old Paige doesn't understand why mommy has to be away all week. By the girls' choice, they and dad have stayed in Charlottesville the past six months to finish school, and Begley flies home on weekends. "There's no question that Chris's flexibility has been essential to my success," she says.

Especially now. She has taken over the $2.3 billion transportation business at a time when sales of its freight and passenger locomotives are slowing. The division's profits were down 8% in the second quarter from the previous year on relatively flat sales. But with her family back in Virginia, Begley can spend half her time traveling to meet customers. Along with trying to become less dependent on North America for sales—no easy task given the political nature of railroad contracts—Begley says she's determined to help railroads take business from trucking rivals.

When Begley looks to the future, as she often does, she's pretty sure it won't include uprooting her family as often. "My kids are my absolute No. 1 priority," she says. "At the point where I can't balance it, they will win." Immelt, for one, respects those limits. "I've been known to work weekends," he jokes. "But I've almost never called Charlene's house on a weekend." Then again, if he tried, he might not get an answer until Monday anyway.

By Diane Brady in New York

ARLENE BEGLEY

RN Oct. 30, 1966, ham, Conn.

BRINGING Father, a finan- director at Yale University, mother raised five daughters, son, and dozens of foster kids.

UCATION BS, business adminis- on, University of Vermont, 1988.

RRENT POSITION President and CEO, GE Transportation Systems.

CAREER HIGHLIGHTS Joined GE in 1988; youngest company officer in GE history (1999); first female CEO of major GE unit (2003).

CAREER LOW POINT First month on audit staff at GE Appliances: "I was miserable. I had no clue what I was doing."

FAMILY Married with three daughters, all delivered on the weekend after she finished work. Her husband, Chris, deferred his dream of becoming a professor to accommodate Charlene.

MOVES SINCE JOINING GE 20.

UNWRITTEN RULE No working on weekends.

STOCKS

INSIDE WALL STREET: A REPORT CARD

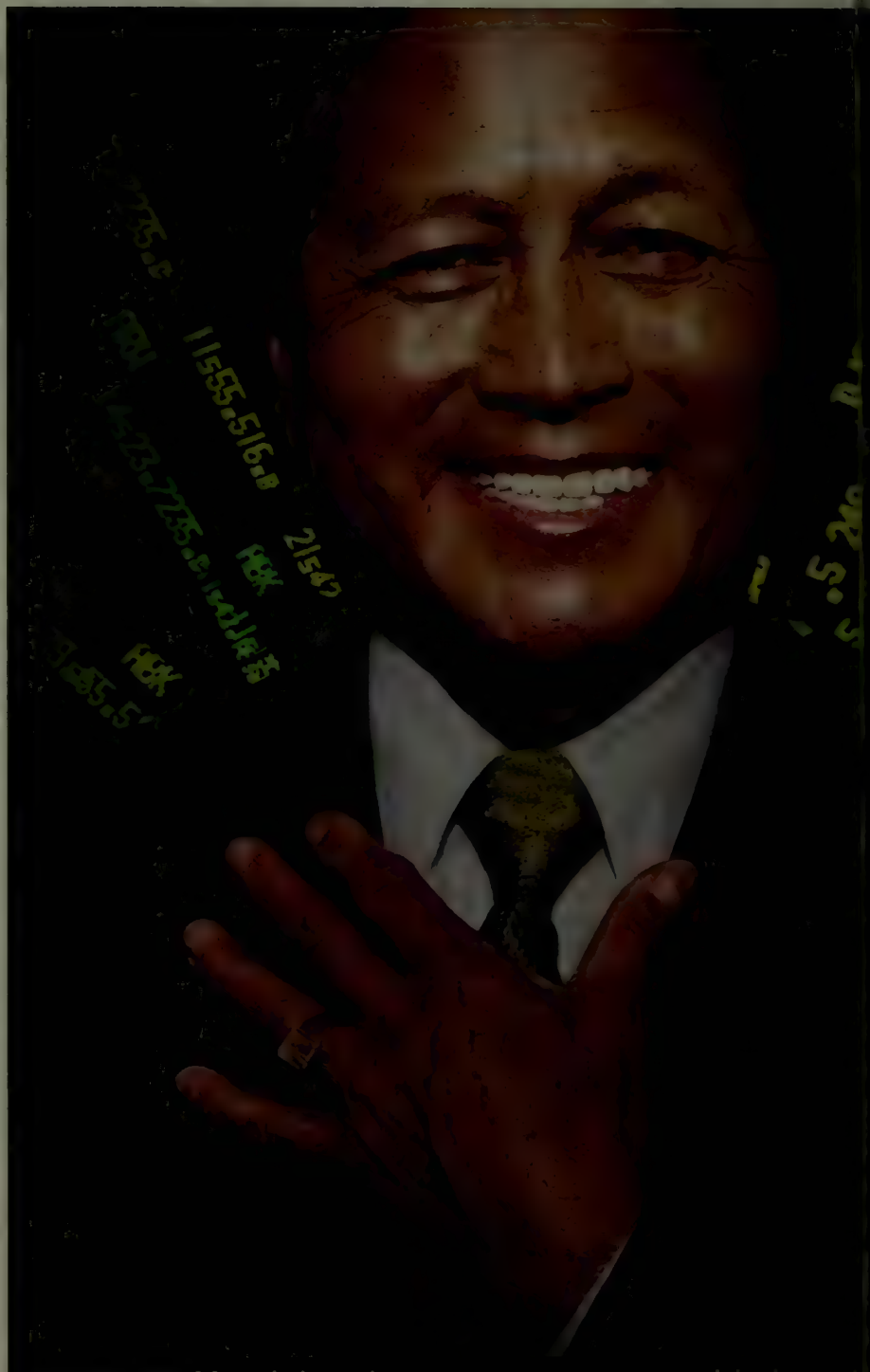
How did stock pundit Gene Marcial do in a treacherous year? Not badly at all, it turns out

After a brutal market in 2001, beleaguered investors hoped that 2002 would be the year the bleeding stopped. No such luck. Accounting scandals and a floundering economy combined to push stocks lower and lower. Investors who followed *BusinessWeek*'s Inside Wall Street column may have lost money as well, depending on how long they held their stock, but they handily outpaced the market averages—no mean feat in such a rough year.

In fact, the column's 160 picks in 2002 beat all five of the major indexes over four different time periods, with only two exceptions: The Nasdaq Composite Index matched the column over six months and the Dow Jones industrial average nudged it out by two-tenths of a percentage point over that same period (table). Overall, it was a performance that any seasoned money manager at a mutual or pension fund would envy.

Gene G. Marcial has written the column nearly every week since 1981, except for vacation relief from *Business Week* colleagues Gary Weiss and Mara Der Hovanesian. Marcial gets his ideas largely by talking with money managers, big investors, or corporate insiders. They may believe that a company is on the verge of an upswing—because of, say, the launch of a promising new product or the prospect of government approval of a hot new drug, or that a company is undervalued and ripe for a takeover. By their nature, Marcial's picks aren't part of a buy-and-hold strategy. Rather, they're trading opportunities that depend on short-term events that can influence a company's future.

Last year, some of the column's best



22-YEAR RUN Marcial probes money managers, big invest and corporate insiders for short-term investment ideas

PHOTOGRAPH BY ETHAN HILL; DIGITAL IMAGING BY DAVID RUDES/BW

s came from the hard-hit technology telecommunications sectors. The est winner, Nextel Communications, ed 93% in the six months after it highlighted in the Oct. 7 issue. Clif- Henry, who runs Worthington vth, a Stamford (Conn.) hedge fund, Weiss that the market had over- ted to the resignation of Nextel's operating officer—a development had just caused the cell-phone gi- stock to drop 16% in a single day. ry was right: Nextel, which had begun to turn around its string of terly losses, turned a $2.6 billion in 2001 into a $1.38 billion gain in

HE BEST PERFORMERS . . .

COMPANY/SYMBOL	GAIN
OVER ONE DAY	
ABIOTICS PHARMACEUT. IBPI	47%
DREON DNDN	22
ROVISION MVIS	19
OVER ONE MONTH	
EL COMMUNICATIONS NXTL	42%
ABIOTICS PHARMACEUT. IBPI	38
ENNIUM PHARMACEUT. MLNM	35
OVER THREE MONTHS	
INGTREE TREE	95%
EL COMMUNICATIONS NXTL	75
EID CPHD	65
OVER SIX MONTHS	
EL COMMUNICATIONS NXTL	93%
ED ONLINE UNTD	62
C SOLUTIONS SNIC	59

. . . AND THE WORST

OVER ONE DAY	
AIR GROUP MESA	–10%
BLOCK HRB	–9
ET SYSTEMS ANS	–7
OVER ONE MONTH	
SSON ERICY	–43%
DFAM-IPEC SFAM	–42
TER HOME ENTERTNMT. TWTR	–38
OVER THREE MONTHS	
SSON ERICY	–60%
LOGIC VLGC	–57
ABIOTICS PHARMACEUT. IBPI	–44
OVER SIX MONTHS	
ON MEDIA PME	–95%
S MEDIA MARKETING XMM	–93
ASENSE THER	–73

ata: Bloomberg Financial Markets, *BusinessWeek*

2002. Its stock, at $7.19 the day before the column hit the streets, was up to $13.86 in six months and closed at $20.03 on July 16.

Inside Wall Street also scored big with United Online Inc., an Internet service provider that was listed as a buy in the Mar. 11 issue. Jonathan Cohen, a money manager in Greenwich, Conn., a frequent source of Marcial's, was bullish, given that United had just signed a pact to provide high-speed Internet service over Comcast Corp.'s vast cable network. Cohen also believed that EarthLink Inc. might make a run at United to broaden its own subscriber base. United hasn't cut a deal with EarthLink, but United shareholders haven't been the worse for it: The online service has boosted its subscriber count 50%, to 2.4 million, over the past year and is now solidly in the black. As a result, United's stock rose from $6.74 to $10.92 over the six months after it appeared in Inside Wall Street and closed at $29.01 on July 16.

The column handily outpaced the market averages. Some of the best ideas came from two hard-hit sectors: tech and telecom

By contrast, the worst performer was Penton Media, a Cleveland-based trade magazine publisher and trade show operator that Marcial pointed to as possibly undervalued in his Feb. 11, 2002, column. Marcial noted that investor Mario Gabelli was mulling a proxy battle to shake up the troubled company, which had seen revenues for its technology magazines and trade shows hammered by the technology downturn. But the proxy battle didn't take place, and Penton's fortunes continued to deteriorate. Its stock, at $6.75 when Marcial recommended it, was just 33¢ a share by last August. Last month, the New York Stock Exchange delisted the company. It now trades over-the-counter, where it goes for 66¢.

To chart the performance of the stocks discussed in Inside Wall Street each week, we start with the closing price on Thursday, just hours before *BusinessWeek* is first available on the Internet. Then we track the stocks for six months, which is why we wait until now to include the performance of the columns published last December. We calculate one-day, one-month, three-month, and six-month returns for each and average them. We then compare them to the major indexes.

Stocks featured in the column usually get a big one-day lift, and that was the case again last year. On the first day of trading after the column was released, the 160 stocks showed an average gain of 2.8%, and all but 60 of them moved the way that Marcial forecast. The biggest one-day winners were two small biotechnology firms: IntraBiotics Pharmaceuticals Inc., which rose 47%, to $51.60, after Marcial reported in the issue dated Mar. 18 that some money managers were predicting great things for the antibiotic that it was developing to prevent mouth ulcers among cancer patients; and Dendreon Corp., a Seattle-based biotech firm whose stock rose 22% after Marcial noted the potential for its prostate cancer vaccine in his Dec. 16 column.

TAKING ON THE INDEXES

Inside Wall Street featured 160 stocks in 50 issues of the magazine last year. For each issue, the returns for the column and the market benchmarks were calculated for four time periods. The returns were averaged over all 50 issues. Here are the results:

	1 Day	1 Mo.	3 Mos.	6 Mos.
INSIDE WALL STREET	2.8%	0.4%	–3.7%	–8.4%
STANDARD & POOR'S 500	0.0	–1.7	–6.5	–9.3
DOW JONES INDUSTRIALS	–0.1	–1.0	–5.1	–8.2
NASDAQ COMPOSITE	–0.1	–2.5	–7.6	–8.4
WILSHIRE 5000	0.1	–1.4	–6.0	–8.7
RUSSELL 2000	0.0	–1.5	–5.9	–9.9

Data: *BusinessWeek*, Standard & Poor's

Not surprisingly, those gains couldn't hold in the wake of a sinking stock market: After one month, the Class of 2002 was up an average of just 0.4%—although that was much better than the 1.7% drop in the Standard & Poor's 500-stock index and similar declines in the other major indexes. But over time, the stocks that were cited in the column headed the same way as the broader markets last year—south. After three months, Inside Wall Street's picks were down an average 3.7%, which nonetheless was enough to outperform the other major indexes.

Considering that the column focuses largely on small-cap stocks, probably the best benchmark to judge the column's performance is the Russell

2000. As the accompanying table shows, it was pretty creditable. He beat the Russell by 2.8 percentage points over one day, 1.9 over a month, 2.2 over three months, and 1.5 over six months. However, even those results weren't enough to offset the brutal market fully. After six months, only 63 of the 160 stocks that the column mentioned were in positive territory. Among the decliners was IntraBiotics, which despite a first-day surge was down 40% by last September. The column's average was down 8.4% over the period—still good enough to beat all the other indexes except the Dow.

Merger targets can be good ideas, but the dearth of deals las had Marcial deemphasizing buyou In 2001, 53 of the stocks he men were cited for their takeover pot But in 2002, he offered 39 tak plays, including the speculation July 22 column that '80s raider T.

THE INSIDE WALL STREET SCORECARD

Here are the 160 stocks featured in Inside Wall Street during 2002. For each stock, we give the last closing price before the column became public, usually a Thursday. Then we compute the one-day, one-month, three-month, and six-month percentage returns. When any of those periods ends on a weekend, the pr day's closing price is used. When a company is over within six months, we calculate prices up t merger's effective date. The Thursday close is 1 before the issue date.

COMPANY NAME/ STOCK SYMBOL	CLOSING PRICE THURSDAY	PERCENT CHANGE 1 DAY	1 MO.	3 MO.	6 MO.	ISSUE DATE
RED HAT RHAT	7.10	16	19	-28	-25	1/14
CAREMARK RX CMX	14.82	–1	11	27	4	1/14
PEC SOLUTIONS PECS	37.82	12	–34	–39	–50	1/14
EMC EMC	17.09	1	–16	–40	–54	1/21
CERUS CERS	47.47	3	–2	15	–47	1/21
NORTHWEST NATURAL GAS NWN	26.50	2	–6	10	4	1/21
CORN PRODUCTS INTL.L CPO	28.04	2	7	14	–1	1/28
SOLECTRON SLR	11.50	–1	–16	–28	–53	1/28
NMT MEDICAL NMTI	8.00	7	–8	–9	–30	1/28
SCIENTIFIC GAMES SGMS	8.17	7	14	14	–19	2/4
STORAGE COMPUTER SOS	6.35	8	12	–13	–73	2/4
LENDINGTREE TREE	7.87	14	–7	95	28	2/4
UNITED INDUSTRIAL UIC	18.75	1	2	35	0	2/11
PENTON MEDIA PME	6.88	–5	11	–4	–95	2/11
MAGNA ENTERTAINMENT MIEC	9.75	2	–8	–16	–43	2/11
SCHERING-PLOUGH SGP	31.40	3	15	–14	–23	2/18
ROWAN RDC	16.65	1	25	47	5	2/18
GENERAL ELECTRIC GE	37.20	0	10	–18	–17	2/18
JONES LANG LASALLE JLL	18.05	0	22	28	19	2/25
WMS INDUSTRIES WMS	16.43	1	17	–11	–16	2/25
BIO-REFERENCE LABS BRLI	5.96	6	17	47	16	2/25
STEAK N SHAKE SNS	12.55	9	15	18	17	3/4
SONIC SOLUTIONS SNIC	5.75	4	16	22	59	3/4
SABA SOFTWARE[1] SABA	13.00	16	34	–8	–27	3/4
AMERADA HESS AHC	69.27	4	15	20	5	3/11
DHB INDUSTRIES DHB	6.65	4	1	–25	–49	3/11
UNITED ONLINE UNTD	6.74	2	28	63	62	3/11
LAFARGE NORTH AMERICA LAF	43.05	–2	0	–7	–28	3/18
ULTICOM ULCM	7.25	10	–1	–10	–18	3/18
INTRABIOTICS PHARM.[2] IBPI	35.16	47	38	–44	–40	3/18
ANNUITY & LIFE RE ANR	18.20	3	10	–8	–69	3/25
TASER INTERNATIONAL TASR	16.16	13	18	–12	–63	3/25
HURRICANE HYDROCARBON[3] HHLF	11.41	12	10	–5	–12	3/25
MIDAS MDS	13.23	2	13	–2	–52	4/1
NEVADA GOLD & CASINOS UWN	6.88	5	6	24	2	4/1
TUTOGEN MEDICAL TTG	4.50	9	–9	–9	–23	4/1
MERCK MRK	57.58	0	–5	–12	–20	4/8
PLAYBOY ENTERPRISES† PLA	17.08	2	23	23	39	4/8

COMPANY NAME/ STOCK SYMBOL	CLOSING PRICE THURSDAY	PERCENT CHANGE 1 DAY	1 MO.	3 MO.	6 M
CROSS MEDIA MKTG. XMM	13.00	2	–2	–28	–93
SEA CONTAINERS SCR/A	17.50	0	–3	–20	–41
ACRES GAMING AGAM	5.35	3	–6	–24	1
NEXMED NEXM	3.33	15	5	–25	–49
BRISTOL-MYERS SQUIBB† BMY	30.56	–2	7	26	25
ASM INTERNATIONAL ASMI	24.31	5	–12	–32	–58
CARDIAC SCIENCE DFIB	2.67	9	21	7	–39
GILLETTE G	34.22	0	7	–15	–9
DAIMLERCHRYSLER† DCX	46.57	0	–7	–4	17
THERASENSE THER	21.25	13	–10	–31	–73
GULFMARK OFFSHORE[4] GMRK	21.12	2	–1	–37	–30
FIDELITY NATIONAL FINL.[5] FNF	21.67	1	10	–1	8
ECC INTERNATIONAL ECC	3.25	–5	–2	–25	–12
MERRILL LYNCH MER	42.94	1	–5	–22	–11
GOLDMAN SACHS GS	80.71	–3	–7	–13	–9
MORGAN STANLEY MWD	48.84	–2	–7	–22	–17
CAPITAL CROSSING BANK CAPX	22.75	11	5	–5	–3
GENTA GNTA	12.34	–2	–25	–32	–35
AMER. PHARMACEUT. APPX	14.00	2	–19	–21	43
JEFFERIES GROUP JEF	47.02	0	–7	–9	–11
J. JILL GROUP[6] JILL	21.60	1	6	–5	3
GALYAN'S TRADING GLYN	18.95	5	20	–27	–29
STERICYCLE[7] SRCL	35.28	3	3	–15	–2
DOVER DOWNS GAMING DDE	13.65	9	–5	–33	–27
PATTERSON-UTI ENERGY PTEN	32.28	–2	–8	–20	–8
SONOSIGHT SONO	16.31	0	–18	–17	–17
CELESTICA CLS	31.30	–3	–26	–23	–44
NEW CENTURY FIN. NCEN	26.65	2	31	15	–30
NASTECH PHARMACEUT. NSTK	15.21	5	8	–35	–34
VORNADO REALTY TRUST VNO	44.14	1	5	–6	–15
HAIN CELESTIAL HAIN	16.97	0	4	–4	–7
CHECKPOINT SYSTEMS† CKP	12.00	0	1	3	6
STELMAR SHIPPING SJH	15.35	1	–1	–9	–1
PFIZER PFE	35.34	0	–9	–16	–14
STRATEGIC DIAGNOSTICS SDIX	4.73	3	–25	–18	–26
JARDEN JAH	17.94	0	13	49	84
MOVADO GROUP MOV	21.65	1	–8	–23	–12
NEWMONT MINING NEM	29.09	–2	–9	0	–2

ens Jr. might make a run at Vintage oleum Inc. Pickens later opted not f those, three have come to pass by July of this year: SpeedFam-IPEC, ht by Novellus Systems last Au- LendingTree, gobbled up by Barry r's InterActive Corp. in May; and eMax Inc., which agreed on July be acquired by Boise Cascade.

veral of Marcial's plays in 2002 companies that might profit from extra spending on homeland security and defense. Among them were Taser International, a maker of stun guns; Cepheid, a biotechnology firm that developed equipment for detecting anthrax; and Strategic Diagnostics, a maker of tests used to determine whether a water supply had been contaminated by terrorists. But Wall Street's initial enthusiasm for such stocks waned quickly: Happily, no other terrorist attack occurred, and the government succeeded in rounding up many leaders of al Qaeda. These three stocks fell between 6% and 63%.

Inside Wall Street once again outperformed the indexes, and the column is a good place to mine for stock ideas. But in today's volatile markets, stock-picking remains a risky business.

By Dean Foust in Atlanta, with Michael J. Mandel, Robert J. Rosenberg, and Sarah B. Davis in New York

IE/	CLOSING PRICE THURSDAY	PERCENT CHANGE 1 DAY	1 MO.	3 MO.	6 MO.	ISSUE DATE
D ABX	20.48	0	–17	–13	–25	7/1
OY	17.68	0	–21	–36	–35	7/1
	20.30	6	–8	27	32	7/8
EC[9] SFAM	4.85	8	–42	–20	16	7/8
GC	2.70	4	–8	–57	–66	7/8
MX	5.37	7	–24	–27	–7	7/15
HL ENT. TWTR	9.95	7	–38	–32	–41	7/15
RICY	11.74	10	–43	–60	–33	7/15
SFT	5.63	–7	6	33	–10	7/15
OLEUM VPI	10.00	3	–2	–9	3	7/22
NCES OCLR	25.02	0	–2	–17	–40	7/22
MICAL LYO	13.48	2	1	–12	–5	7/22
MOTION RIMM	13.24	–3	–21	–14	3	7/29
IP RYL	40.47	–6	10	–5	–8	7/29
S MWY	4.52	2	18	–6	–8	7/29
HINE SMD	9.50	–1	–8	19	–26	7/29
HNSON JNJ	48.70	2	13	19	10	8/5
	10.00	3	23	–10	54	8/5
MGR	18.50	6	26	11	1	8/5
RT LIVING MGO	7.92	7	–6	–3	18	8/12
IDE MFW	5.35	6	–9	–2	26	8/12
NGR	15.59	1	3	22	17	8/12
	24.75	3	0	1	4	8/26
NOLOGIES SBL	9.10	–1	–1	–6	–12	8/26
ITL. IGI	19.70	–1	–4	1	–3	8/26
AL TECH. APSG	10.86	1	–8	–2	15	9/2
ERA LENS	4.96	1	–1	13	17	9/2
.	4.10	5	–35	–21	–53	9/2
S SQUIBB BMY	24.29	3	1	9	–4	9/9
YOMING GWR	22.55	0	0	–13	–32	9/9
DUS. FBAY	10.25	9	–17	6	–3	9/9
FINANCIAL FBF	22.75	3	–18	9	7	9/16
	19.13	4	–18	–37	–39	9/16
ATION STRA	56.70	3	–3	7	–2	9/16
	3.10	3	–1	5	–32	9/23
	4.81	1	–31	35	2	9/23
)	3.74	14	5	65	–6	9/23
	14.89	–2	–13	30	42	9/30
MS ANS	5.15	–7	–15	–5	–44	9/30
ROUP MNTG	8.22	2	10	–12	–17	9/30
NCC	29.18	–3	–4	–6	–4	10/7
UN. NXTL	7.19	2	42	75	93	10/7

COMPANY NAME/ STOCK SYMBOL	CLOSING PRICE THURSDAY	PERCENT CHANGE 1 DAY	1 MO.	3 MO.	6 MO.	ISSUE DATE
MERIDIAN GOLD MDG	18.18	0	–12	0	–47	10/7
AMAZON.COM AMZN	16.75	–1	18	23	59	10/14
CASUAL MALE RETAIL GRP.MRG	3.50	–3	9	13	5	10/14
ORPHAN MEDICAL ORPH	8.10	–2	11	17	6	10/14
AGCO AG	22.47	6	11	–2	–24	10/21
WEIGHT WATCHERS INTL. WTW	44.00	3	12	–3	7	10/21
SKYEPHARMA SKYE	7.01	0	4	4	5	10/21
HOME DEPOT HD	29.15	4	–3	–23	–6	10/28
OUTBACK STEAKHOUSE OSI	28.36	3	20	22	30	10/28
SUEZ SZE	17.53	0	3	14	–18	10/28
HOVNANIAN ENTERPRISES HOV	38.00	–1	–13	–16	5	11/4
WAL-MART WMT	56.47	2	–5	–16	–2	11/4
APACHE APA	52.51	–2	–5	10	16	11/4
NABORS INDUSTRIES NBR	35.83	–4	0	–5	16	11/4
PRAXAIR PX	51.17	2	11	6	12	11/4
IMC GLOBAL IGL	11.65	–1	3	–10	–22	11/4
MESA AIR GROUP MESA	6.14	–10	1	–28	–20	11/4
NCO GROUP NCOG	11.82	7	26	24	41	11/4
INTUIT INTU	51.92	4	4	–15	–25	11/11
COX COMMUNICATIONS COX	27.40	2	11	6	21	11/11
VERIDIAN VNX	23.96	–4	–12	–12	–21	11/11
MILLENNIUM PHARM. MLNM	8.28	5	35	–19	41	11/18
H&R BLOCK HRB	35.35	–9	9	1	7	11/18
SUNCOR ENERGY SU	14.69	3	5	13	17	11/18
TIFFANY TIF	27.99	3	–9	–17	11	11/25
ALASKA AIR GROUP ALK	22.40	0	0	–19	–15	11/25
O'CHARLEY'S CHUX	20.20	0	–3	6	–7	11/25
LIBERTY MEDIA L	10.16	3	–11	–10	9	12/2
XEROX XRX	8.66	–5	–8	3	20	12/2
INVERNESS MED. INNOV. IMA	10.70	6	26	39	58	12/2
NVR† NVR	339.50	2	2	0	–20	12/9
WENDY'S INTL. WEN	28.40	–2	–4	–11	2	12/9
NAPCO SECURITY SYST. NSSC	9.80	0	–3	–11	–16	12/9
APPLE COMPUTER AAPL	14.63	2	2	0	21	12/16
MICROVISION MVIS	5.43	19	8	–27	–1	12/16
DENDREON DNDN	4.70	22	17	–7	46	12/16
STERICYCLE† SRCL	31.78	–1	–14	–11	–21	12/23
DEL MONTE FOODS DLM	8.71	–1	–2	–13	4	12/23
SIGA TECHNOLOGIESSIGA	1.65	–1	–11	–35	10	12/23
INSTINET INET	3.89	–2	8	–14	25	12/30
EXACT SCIENCES EXAS	10.75	4	–7	–9	13	12/30
SINGING MACHINE SMD	10.87	–6	–36	–36	–47	12/30

se split, 5/12/03
rse split, 4/11/03
3 PetroKazakhstan (PKN)
7/1/02
5/27/03

6. 3 for 2 stock split, 6/28/02
7. 2 for 1 split, 6/3/02
8. 1 for 5 split, 11/19/02
9. Acquired by Novellus annc. 8/12/02 compl. 12/6/02; 0.1818 shares of Novellus per share of SpeedFam.
10. 1 for 10 split, 10/23/02

† SHORT. In calculating the returns on the short selling, we did not consider the leverage that sellers use. But in the summary table on page 79, we assumed that short sellers borrowed 50% of the sale at an 8% interest rate.

INTELLECTUAL PROPERTY

WORTH BUILDING A FENCE AROUN

The word is passed around at after-school pickup: For knockoff Kate Spade handbags, go to Janie's tonight. No seedy street-corner this, but a well-appointed living room in a wealthy Manhattan suburb. Across town, one neighbor lends another her Microsoft Windows software to reboot her crashed computer. Another tees up his VCR with a bootlegged version of *The Matrix: Reloaded,* which he scored on a business trip to Hong Kong before the movie had made its first $50 million at the box office.

Sound familiar? Such everyday thefts help roll up billions in annual losses for U.S. companies. Piracy of intellectual property (IP) affects virtually every industry sector, draining profits and jobs across the board, from garment makers to computers, entertainment, pharmaceuticals, and automobiles. Our increasingly information-based economy raises a host of new threats: The Internet reduces the most ornate strategic plan or trade secret to bits and bytes, accessible to any hacker anywhere. Yet many of the solutions – IP protection and enforcement – are already in place.

EXPERTS BELIEVE THAT IP NOW ACCOUNTS FOR 20% OF AMERICA'S CORPORATE ASSETS.

The need for vigilance is intensifying. According to the Bureau of Labor Statistics, the IP-based sector of the U.S. economy grew nearly twice as fast as the economy as a whole between 1977 and 1996. Combined U.S. copyright and derivative businesses now account for nearly 6% of the gross national product, according to the FBI's financial institution fraud unit, and experts believe IP amounts to 20% of America's corporate assets.

Given IP's growing importance – not just in a company's market strategy but in its valuation – how can companies nurture their IP investments? Gladys H. Monroy, partner and co-chair of the patent group at San Francisco-based Morrison & Foerster LLP, suggests her clients – most in life sciences – establish an atmosphere that encourages invention. Next, she recommends they appoint an in-house IP committee th

- Create or assess the procedures for disclosing inven
- Determine whether inventions are patentable
- Decide if IP protection for a particular product/proce the company's overall strategy and plans
- Monitor the ongoing patent portfolio in reg maintenance and potential infringements

The IP attorney shepherds the process – whether copyright, trademark, or trade secret – through the app ate U.S. or international channels. Obtaining a can be arduous and costly, but it can provic ical advantages. "A patent gives a compa opportunity to recoup its R&D costs f patented invention, as well as make a prof limited amount of time," says Monroy. Also, up astute enough to secure patents can licens to generate the funds to develop its own pro

The explosion of Internet-based busine opened a Pandora's box of IP theft possibilitie Marc S. Friedman, member and chair intellectual property group at Sills Cummis Tischman Epstein & Gross in Newark, NJ. For instance, copyright protection is obtained, any business that u outside web designer to build a web site is vulnerable to co infringement. Unless assigned in writing, the copyright web site belongs to the web designer – who could turn a and use virtually the same site for a competitor.

Companies, especially in the technology sector, car profit from combining IP protections, says Friedm software developer with a potentially hot new product consider distributing the software to licensees in objec form, creating a trade secret program to protect the source relying on copyright protection for the user documentatic manuals, and applying for a patent on the underlying inve The company's own business plan will help dictate the of IP protection it needs. "Context is everything," says Frie

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Point of Law
Developments in Intellectual Property

Stopping Gray Market Goods is *Not* Always Black or White

Gray market goods are typically products meant for markets outside of the United States but which nonetheless appear on U.S. shelves without the consent of the U.S. copyright and/or trademark owner. Owners object to the importation of gray market goods for a number of reasons.

First, the goods in question may have been tailored for a foreign market, and therefore, importation into the United States could hurt the value of the owner's brand if the goods fail to perform as a U.S. buyer expects. In an extreme case such as electronics, the goods may not be usable in the U.S. or might even pose a hazard.

Second, the owner may have established a domestic network of authorized dealers to distribute its products; gray market goods may reduce demand for products sold by the authorized dealers.

Third, the mere fact that the products are offered in a discount channel could damage the brand, especially one for which production and distribution is purposely limited to increase cachet. Finally, the intellectual property owner may receive reduced royalties for goods sold in foreign markets, yet have an obligation to provide (or pay for) warranty work and other service for those goods in the hands of a U.S. purchaser.

The logical question, then, is how an intellectual property owner can prevent the importation or sale of gray market goods. Although U.S. law imposes limitations on when goods meant for a foreign market can be imported into the U.S., owners have met with mixed results in using intellectual property laws to protect their distribution channels. A trademark owner would be wise to evaluate whether or not its corporate structure is optimized to enhance its ability to use those laws to thwart gray market activities and to stop the goods at customs.

Clearly, the most effective method is interdiction designed to keep the foreign market goods in the foreign market. A contractual limitation on the distributors and retailers to whom the owner sells the foreign market goods is a good place to start. Frequently, however, it is difficult to trace the source of gray market products, making enforcement difficult. Nevertheless, owners should vigorously monitor the distribution chain; diverted shipments are often an inside job. Cooperation of distributors is essential.

GOLDBERG KOHN

The Intellectual Property Group at Goldberg Kohn combines transactional and litigation attorneys who counsel clients on all aspects of their trademarks, copyrights, domain names, trade secrets, licensing/distribution agreements and advertising. The firm works with clients to protect the value of their corporate identities, including tradenames, logos, trade dress, domain names and Web site designs. The firm's lawyers are proactive advisors to businesses, including major manufacturers, retailers, service companies and not-for-profit entities, on the evolving legal and evidentiary issues, including e-mail retention. For more information about Goldberg Kohn's Intellectual Property Group, please contact William C. Meyers at 312-201-3919 or via e-mail at William.Meyers@goldbergkohn.com.

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Global Patent Litigation

Companies that have worldwide operations, international sales, or foreign patents must prepare for patent litigation on a global scale. Increasingly, parties bring patent claims simultaneously in multiple countries. Global patent litigation demands consideration of many factors, including: cost, speed, availability of evidence, and remedies–including injunctions and damages.

Patent owners that gather solid, easily understood evidence consider Germany and the Netherlands excellent choices. Both jurisdictions provide for early injunctions stopping infringement, sometimes within a few weeks of filing. In the Netherlands, the kort geding procedure can yield an injunction within four weeks.

In Asia, however, rapid relief may prove elusive. In Taiwan, for example, most patent cases are suspended until the completion of separate invalidity proceedings, typically initiated by a defendant after being sued for infringement. Because the invalidity proceeding can last two years (or more), the infringement trial may not take place for three or four years. In contrast, across the Taiwan Straits, domestic Chinese corporations can get to trial within six months. The same is typically not true for foreign corporations.

If your company has been threatened with patent infringement litigation, England may be a good choice. Anecdotally at least, English courts are quite willing to invalidate patents. This makes a preemptive strike to have your competitor's patents declared invalid option. Additionally, allows a party to bring seeking damages if it has been threatened but not yet sued for, infringement in Englan

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case can be used to off inevitable infringement follow.

In contrast to patent li in the United States, involving hundreds of thc of documents, many countries (including Netherlands, Taiwan, G and China) traditionall had no document excha discovery) process. Wh may reduce costs, it mea must find all evider infringement yourself unl can use information ol through discovery in co-p U.S. litigation.

Strategically selectin combining advantageou isdictions is a critica toward successful global litigation.

Point of Law
Developments in Intellectual Property

The Biotech Patent: To License or Litigate?

1989, a small biotech ny named CellPro was d to develop a stem cell tion technology. Upon approval, it became the ach commercially viable ue. However, a university her had also developed echnique and een awarded a for it. He d his patent to company, and mpany offered nse the patent llPro in return royalty. CellPro d the offer. After the ensuing ement lawsuit, was required damages, and njoined from ng its own pro- Even though it t to the market new technology, ultimately went usiness.

existence of ly held biotech- patents, some ch are of questionable often confronts man- ith the choice of taking nsive license or refusing nse and assuming the f litigation. Taking a largely eliminates the at the company will the next CellPro. How- iotech patent royalties very high, payment to ent owner may not elim- e risk with respect to otentially adverse patent and paying excessive s on patents that are lid is not something npany can afford to do. h companies must have nal method to value l licenses and to balance and expense of litigation against the cost of taking a license. Even if the patent is of doubtful validity, the decision-maker must still consider the expense of litigation and the consequences of losing. In addition, patent owners often have different strategies for enforcing their patents, which can affect the availability and value of licenses. For example, although universities have become highly sophisticated about exploiting their research, most are uninterested in developing commercial products, and will usually grant patent licenses on reasonable terms. On the other hand, large, well-funded companies may use their patents to protect their own products, and will therefore license, if at all, only on payment of significant royalties. The decision whether to accept or reject a patent license requires careful balancing of risks and rewards, and the wrong decision can have far reaching consequences.

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Intellectual Property Law

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Are You Farming, or Merely Subsisting?

Only a few decades ago an inventor had to have experienced a flash of inventive genius as a prerequisite to the patenting process; no "light bulb over the head," no patent. Such a requirement, however, correlates poorly to whether an idea is an "invention" or not (let alone a commercially worthy invention). Many of the most valuable inventions are instead the result of painstaking iterative steps, evolutionary progress, and methodical reflection. Congress therefore legislated this requirement out of existence and established the clear notion that an invention is patentable, or not, by objective standards that ignore the means by which an invention is conceived.

Notwithstanding that our legal system essentially ignores how an invention comes into being, many companies continue to practice a reactive patent acquisition process. Few ask, "Should we patent this?" until an engineer or scientist has developed a new idea that he or she then puts on the table for consideration. This is akin to cultivating only those plants that happen to grow through circumstance on one's land. And many patent conscious companies practice an even more constrained reactive process – an invention is not seriously considered for patenting unless and until a commercially feasible, debugged, working model exists.

While worthy patents can and do result from such processes, there are other ways. One can chose to proactively identify content of likely present or future value to the business and then seek to enable those concepts with demonstrable embodiments that can then serve as patent application fodder. One cannot guarantee that every seed will grow, but one can likely improve the odds that something of value will result when seeds are purposefully selected and then methodically planted, tended, and, yes, culled from time to time.

Once one begins to think proactively, numerous opportunities present themselves. One can seek to instigate purposeful patenting activity in response to evaluation of a competitor's patent portfolio, anticipation of or participation in the development of a legal or industry standard, anticipated or recently arrived breakthrough technologies or disruptive technologies, monetization plans or needs, and of course the strategic development of one's own patent portfolio to reflect and accommodate the anticipated trajectory of one's own business and technology.

To continue the analogy, it is planned agriculture or subsistence gathering – those are the choices.

Fitch, Even, Tabin & Flannery
Intellectual Property Law

Fitch, Even has been assisting businesses for over one-hundred forty years in areas such as

- Developing IP strategy and building an IP portfolio that maximizes return on investment.
- Litigating IP disputes.
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This is about the investor who uncovered

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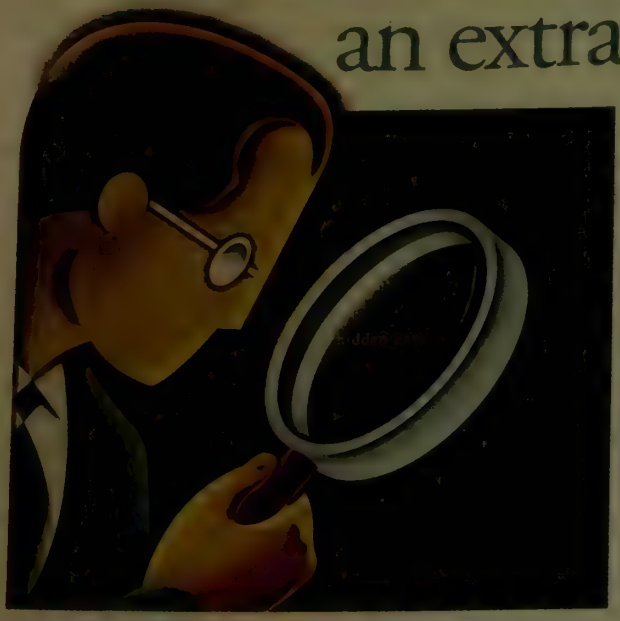

While investing can never promise a sure thing, it does offer a few absolutes. One being that, if you have two funds and both perform identically, the fund with the lower expense ratio will ultimately return more than the other.

Which is why it pays to scrutinize a fund's fees and expenses up front.

For example, take a fund with an expense ratio of 1.3 percent versus one with an expense ratio of just 0.3 percent. Applied to an initial $25,000 investment returning 8 percent and compounded over 20 years, the difference adds up to a hard-to-overlook $19,751 that could be in your account.

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BusinessWeek

Investor

28, 2003

MAKING LIFE RICHER

Guide to Retirement

How to Meet Your Goals Page 88

Where To Cast Your Net Today

New tax laws and an improving stock market make smart retirement planning even more crucial. BY MIKE McNAMEE

AT LAST, A RAY of sunshine. The four-month-old recovery in stock prices is beginning to heat up returns on 401(k)s and other retirement accounts. Those brave enough to open their statements are getting a pleasant shock: Stocks rewarded them with a positive return in the second quarter, only their fourth quarterly gain since March, 2000. Signs are everywhere that this time, the warming trend could last. Retirement plans are still suffering a lot of damage—but savers can finally see some reason to make repairs.

So there couldn't be a better time for BusinessWeek's Annual Retirement Guide. In the pages that follow, you'll learn more about the new realities of retirement planning after the bear

market. You'll also find the advice you need to reevaluate your retirement plans and prepare for the coming upswing: How to recast your 401(k) to get the best returns with the least risk, how to tap the hidden wealth in your house, and how to build a human-capital portfolio of skills that can extend your earning power and enrich your later years more than any stock or bond ever could.

It's not just Wall Street's recovery that's lifting retirement wannabes out of their three-year funk. Savers are gaining important new tools to help them prepare for—and reach—their golden-year goals. Software developers are offering ever-improved programs for projecting your financial needs. Advisers are tuning up new products to make your retirement dollars go further—such as improved annuities, insurance contracts that guarantee income for the longer life span today's workers can reasonably expect.

CAPITOL ASSISTANCE

Washington, too, is helping. This year's tax cut frees up cash for your retirement stash and makes investing more attractive, with lower taxes on capital gains and corporate dividends. "Nobody expected the tax cuts to be this large—and retroactive to the start of the year," says Paula Hogan of Hogan Financial Management, a Milwaukee planning firm. "It's a great opportunity to save." And long-awaited legislation that could help 401(k) savers get more advice for their accounts is increasingly likely to pass.

But all these tools are useless unless

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ANTHONY RUSSO

"If we take a late retirement and an early death, we'll just squeak by."

you're prepared to act. Dan Moisand of Spraker, Fitzgerald, Tamayo & Moisand, wealth managers in Melbourne, Fla., tells his clients: "We've all suffered the shell shock. Let's move on and talk about the future." Here's how to get rolling:

■ **Assess where you are.** Before he talks about retirement accounts, financial planner Marc Freedman insists his clients prepare or update their net worth statement. Soaring home prices help ease the pain of 30%-plus declines in 401(k) balances. "When you look at total wealth, people haven't lost as much in the past three years as they think they have," says Freedman, president of Freedman Financial Associates in Peabody, Mass.

"When you look at total wealth, people haven't lost as much over the past three years as they think they have"

If you're like most 401(k) participants, Wall Street's storms haven't driven you to take cover: 63% of 401(k) contributions are flowing into stocks and equity funds in 2003, down only slightly from last year's 68%, according to 401(k) manager Hewitt Associates. That cost you during the bear market: An investor who went to cash at the market peak in March, 2000, would be 49% ahead of a stock investor now, according to Ibbotson Associates. But such market-timing generally only works in hindsight, because research shows that missing peaks or troughs by just weeks or even days can deplete a would-be timer's returns. And stock loyalists are far better positioned for the upswing: Since March, their accounts are up 18.5%, Ibbotson says, while cash has only gained 1.9% (including contributions).

■ **Determine where you're going.** Have your retirement goals changed in the past three years? The bursting of the tech bubble, the recession, and the events of September 11 have inspired many Americans to rethink what they want from their lives. Most baby boomers are planning to keep working, part-time or in a second career, after they've formally retired. They fret that a life of leisure will only make them grow old sooner. Earned income, even at a scaled-down job, can stretch a retirement portfolio by years, adding security to cope with today's longer life spans.

Fifty-five-year-olds in the home stretch of their career will have an easier time envisioning retirement than 35-year-olds just hitting their stride. But even a younger saver needs a plan to figure out what to save. You can with the new rules of thumb calc by fund and annuity manager TIA (table, page 92). For instance, have 15 years to go before retire you should have already bank times your annual salary if you suming assets will grow at 8% a y you expect just 6% growth, you have accumulated 3.5 times your

■ **Clean up.** Chances are, the s stocks and boom in bonds has re the proportion of stocks in your p lio below your target level. So it' to rebalance: Sell some bonds an more equities.

In your taxable accounts—outs your 401(k) or individual retireme count—look for tax savings a stocks that are worth less than yo for them. If you sell the shares they're down, the losses can be u offset profits and avoid taxes on investments. Beware of the In Revenue Service's "wash sale" You can't deduct losses if you bu sell the same security within 30 da avoid that, buy more shares of the at least 31 days before you plan t or buy a similar stock after you s

■ **Be realistic.** The NASDAQ Com Index has been climbing steadily since March—but already "many ple are returning to unrealistic e tations," says Harold Evensky of r

The Surprise Threat to Nest Eggs

Don Lane thought he was set when he retired three years ago at 54 from a computer job in Wichita Falls, Tex. To him over until he could collect Social Security at age 62, he put his savings safe, fixed-income investments. Most into 20-year Fannie Mae and Freddie bonds yielding over 7%, the rest into a money-market fund yielding 5%.

Then came disinflation—and a stee in interest rates. Fannie Mae and Freo Mac called his bonds, and when he b new ones, those were called, too. The coupons on his current bonds are just 5%—and subject to calls. Meanwhile, money-fund yield is less than 1%. "It t

odest Expectations

stors' rich returns for the last 20 years e fueled in large part by falling interest s. From 1982 to 2002, long-term rates ped from 14% to less than 5%. Starting today's low level of interest rates, it's kely to repeat that move in the next 20 s. That's why pros are counseling clients ace themselves for lower returns—and h less money left over after taxes, stment expenses, and inflation.

	AVERAGE RETURN 1982-2002*	FUTURE EXPECTED RETURN*
Gross return	14.0%	7.8%
Expenses	1.0	1.0
Taxes (20% of net)	2.6	1.4
Inflation	3.0	3.0
Real net return	7.4%	2.4%

*Based on a portfolio that's 60% stocks and 40% bonds

Data: Evensky Brown & Katz

gers Evensky, Brown & Katz in Gables, Fla. "They think we're to happy days again."

e sad truth: The hefty stock and returns investors have enjoyed 1982 were once-in-a-lifetime re- for the Federal Reserve's taming lation and Corporate America's tural makeover. Those victories up stock prices 2.5 times as fast growth in corporate earnings—an tion not likely to be repeated. Ibbotson, chairman of Chicago chers Ibbotson Associates, calcu- hat stocks will return only 8.5% in nds and capital gains over the decade—a mere 5.5% after infla- down from the 10.2% average unded return since 1926.

he's right—and a host of financial ts agree with Ibbotson's reason- ing, if not his exact figures—you'll need to save sooner, save more, and save smarter to finance the kind of comfortable retirement you want.

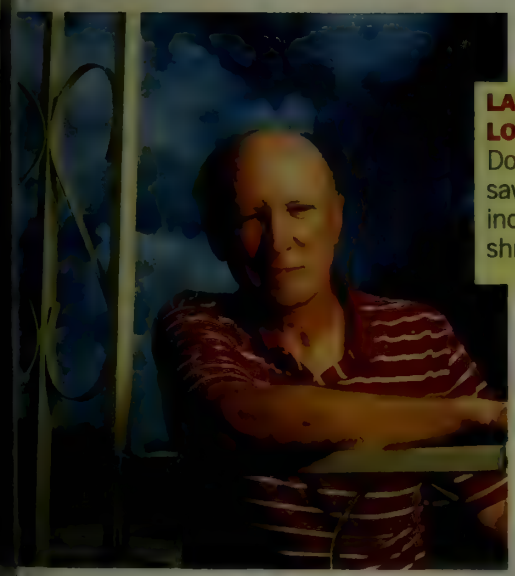
■ **Save more.** The recently passed tax cut can help. A family of four with $110,000 in income and typical deductions can expect to net an extra $1,470 this year—$800 in a check from Treasury for an increase in the child tax credit, $335 from smaller tax payments withheld from second-half paychecks, and another $335 in a larger tax refund next spring. President Bush hopes you'll spend that cash to help revive the economy—but you'd be smarter to divert the funds into a 401(k) or IRA before they ever hit your checkbook.

■ **Place your funds carefully.** The tax cut also creates new incentives for saving by slashing the top tax rate on stock profits to 15%—down from 20% for long-term capital gains and as high as 38.6% for corporate dividends. You should still concentrate first on filling up your 401(k): You pay no taxes on the first $12,000 in annual income ($14,000 for workers 50 and older) that you put in your 401(k) this year. In addition, your employer may match some portion of your savings.

If you're an avid saver who exceeds those limits, you'll get more flexibility, and probably pay less tax over your lifetime if you put the excess in a taxable account. You'll pay the low 15% stock-profit rate each year, rather than ordinary-income rates of up to 35% when you withdraw funds.

The new lineup: Use your 401(k) for money funds and bonds that you intend to hold to maturity (interest is taxed as ordinary income). If your 401(k) allows active trading, save space there for stocks and mutual funds that you plan to hold for less than a year (short-term capital gains are still taxed at higher rates). Use your taxable account for high-dividend stocks and securities that you plan to hold for at least a year.

■ **Cut investment costs.** In a world of smaller stock returns and low interest rates, investment costs—fees, commissions, taxes—matter more than ever (table). That strengthens the case for indexing—buying mutual funds or ex-



LAID LOW BY LOW RATES: Don Lane saw his income shrinking

he monthly bill for water, trash, and " Lane gripes. "I'm having a race n the cash I have in the bank and e until I get Social Security."

rement planning has always sized protecting nest eggs from the ing effects of inflation. These days, retirees are reeling from a disinflationary wind that few could have expected a few years ago. Some economists even forecast outright deflation.

Government data confirm that low rates hurt retirees and near-retirees more than they hurt younger people. According to the Federal Reserve's Survey of Consumer Finances, 30% of households headed by someone age 65 to 74 owned certificates of deposit in 2001, as did 37% of households headed by someone 75 or older. By contrast, only 15% of households headed by 45-to-54-year-olds held CDs. And people in or near retirement borrow less, so they don't enjoy the bright side of low rates. Among the 75-and-overs, only 29% of households carry any debt at all, compared with 85% of the 45-to-54 group.

What to do? Most people in or near retirement can't afford to take a lot more risk in search of higher yields. The safest advice is to cut costs. If you still have a mortgage, refinance it at today's low rates. Beyond that, the right strategy depends on what you expect to happen next. Deflation, if it hits, would probably be accompanied by a recession. In that case, ultrasafe Treasury bonds would post excellent returns. Another good bet would be an annuity with a fixed monthly payout—as long as the issuer is unlikely to default.

Don't get fixated on deflation. With low inflation and weak economic growth, an array of bonds, including investment-grade corporates, should do well, as should blue-chip stocks in sectors such as health care that aren't vulnerable to imports.

Build an inflation hedge into your plans. The U. S. Treasury's TIPS or I-Bonds are great choices, since their values increase with the cost of living. Inflation is no friend of retirees. But as Don Lane can tell you, it's not their only enemy. *Peter Coy*

change-traded funds (ETFs) that aim to mimic a particular slice of the stock market. With little management and trading, index funds are low-cost and tax-efficient—and just as rewarding over the long run as the typical actively managed fund.

In the stock portion of accounts he manages, Evensky has adopted what he calls a "core and satellite" approach. The core—80% of the account's equity allocation—is invested in three or four low-cost index funds that cover the broad market, value stocks, and international equities. With the remaining 20%, "we take extra risks to try to beat the market," Evensky says.

His current mix: microcap stocks, emerging-market stocks, and a fund that short-sells 30-year Treasury bonds to profit from rising long-term interest rates. The stability of the core holds down fees, taxes, and risk, while the satellite gives Evensky the freedom to seek an extra kick.

■ **Recognize risks.** The bear market has taught investors that stocks don't always go up—and can go down for long periods. But there's another risk that retirees can't experience first-hand until it's too late: Longevity risk, or the chance of outliving their savings. For a couple age 65 today, there's a 37% chance that at least one spouse will celebrate a 95th birthday. "The first generation of 401(k) savers, which has already taken on unprecedented responsibility to manage their own retirement, now has to figure out how to make their funds last 25 or 30 years," says Ron Danilson, vice-president for retirement and investor services at Des Moines-based Principal Financial Group.

A $1 million mutual-fund portfolio earning 7.3% has an one-in-seven chance of leaving you broke within 30 years if you withdraw $40,000 in the first year and increase your payouts with inflation, according to Ibbotson Associates (table). With a $50,000 first-year withdrawal, you have a one-in-three chance of having no money in 30 years.

To handle this risk, financial advisers are turning to an old tool: Immediate annuities, insurance policies that convert an up-front premium into a guaranteed stream of payments for life. These aren't variable annuities, heavily promoted as a tool for deferring taxes on savings; the new tax cut will render those expensive vehicles less attractive. Instead, planners are focusing on annuities' payouts during retirement as a means of insuring against living too long. Even with today's low rates, a 65-year-old couple with $1 million could purchase a fixed annuity that would pay them $59,700 a year for the rest of their lives. If they want inflation protection, they could elect a first-year payout of $44,300 that would increase each year with the cost of living.

Pay close attention to longevity risk: People are living much longer, so your money may have to stretch further

Many retirees resist buying annuities because the insurance doesn't leave anything for heirs. "People focus on the chances that they'll die before they get all their money back, rather than on the risk that they'll c their money without an annuity," John Ameriks, senior research fe the TIAA-CREF Institute. Insure responding with new products t fer a payout for heirs (albeit expense of the retiree's income) cipal Financial offers a rollov that gradually converts from fu annuities, providing flexible sp during a retiree's active year guaranteed income later.

Eventually, this emphasis on ities should ease the savings b on workers. Instead of every having to save enough to cov chance they'll need income for 30 annuities will pool savings to cov most long-lived. But research on ing annuities into retirement por is still in its infancy, and estima their impact on the need to sa scarce. "I wouldn't tell peo cut back on their savings," Danilson.

Indeed, if you're waiting for one to tell you to save less, you're a disappointment. The bear claws last three years should have rip any illusion that catching the bra would be easy. But with the r turning up, Washington pulling c stops to help savers, and new pr catering to a baby boom chargi ward retirement, you can at lea forward—and get back on your with renewed optimism.

How Annuities Can Help

A 65-year-old couple with $1 million has two choices: Invest the money themselves, or buy an immediate-payout annuity. The annuity offers a guaranteed income as long as one of the couple is alive. Principal Financial Group compared two annuities—one with a constant payout rate and one that increases with inflation—against the chances of running out of money with a do-it-yourself (DIY) portfolio that's 60% stocks, 40% bonds, earning 7.3% a year:

ANNUAL WITHDRAWAL	PROBABILITY FUNDS WILL RUN OUT IN... 25 YEARS	30 YEARS	35 YEARS
FIXED PAYOUT			
DIY $50,000	4%	7%	10%
Annuity $59,700	0	0	0
DIY $60,000	13	20	25
INFLATION-ADJUSTED PAYOUT*			
DIY $40,000	7%	14%	21%
Annuity $44,300	0	0	0
DIY $50,000	23	35	44

* Payout amount is for first year. After that, payouts increase with Consumer Price Index; the DIY scenario assumes 2.7% inflation.

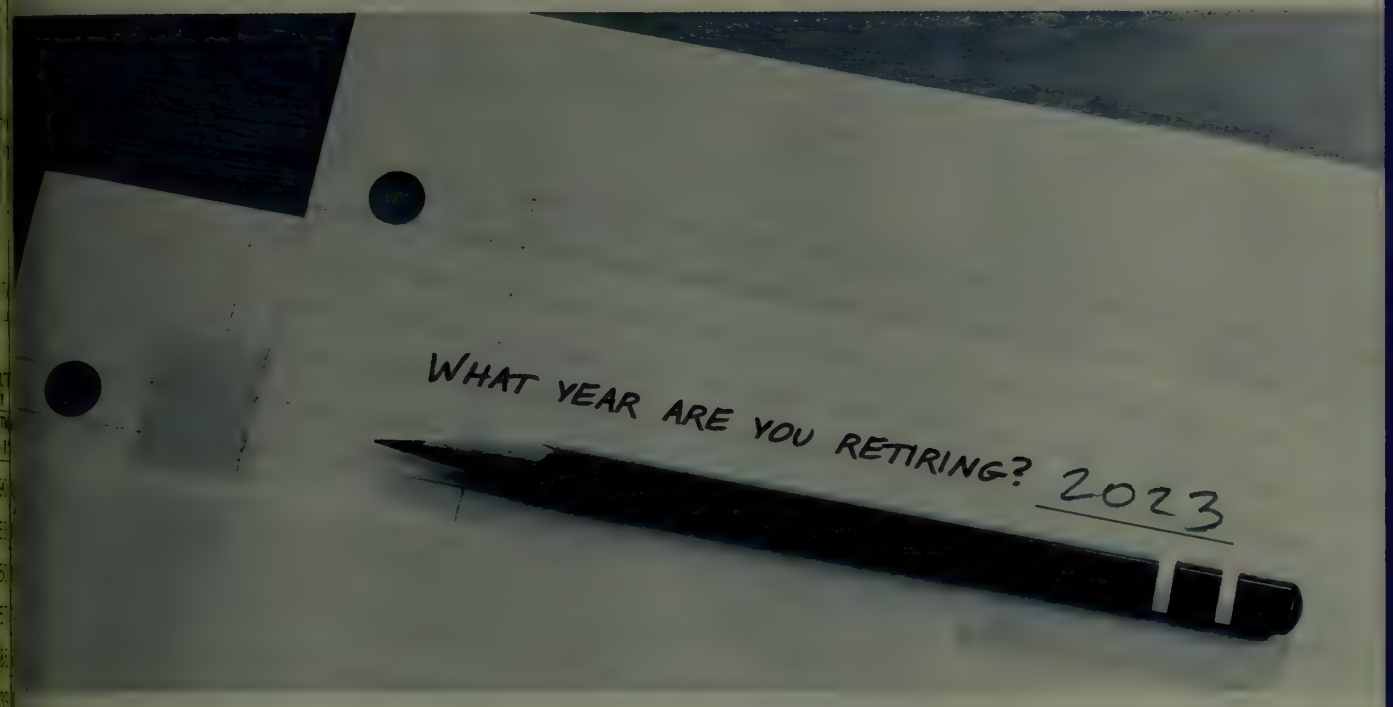
Data: Ibbotson Associates, Principal Financial Group

New Rules of Thumb

A million in the bank on your 65th birt is no longer the yardstick for success i retirement planning. TIAA-CREF gives these new guidelines for how much yo need in savings—as a multiple of your current salary—to replace half of your earnings at retirement.* Social Securit other pensions are expected to make u rest of your needs.

YEARS TO RETIREMENT	ASSETS NEEDED AS A MUL OF CURRENT SALARY IF INVESTMENTS EARN 6%	IF INVEST EARN
25	2.00	0.9
20	2.72	1.6
15	3.51	2.5
10	4.38	3.5
5	5.34	4.8
0	6.39	6.3

* Assets are used to buy an immediate annuity that guaran time income. Data: T



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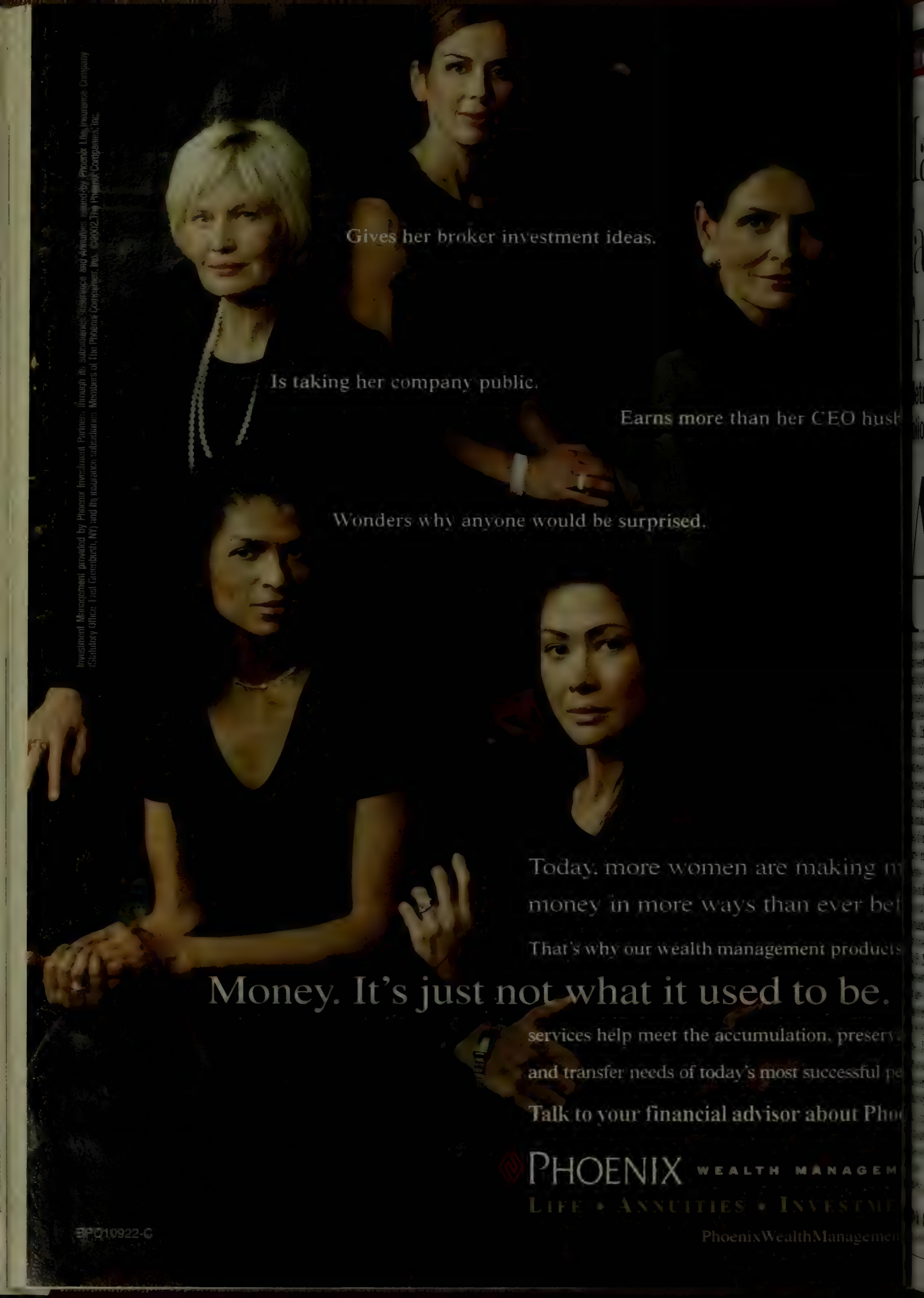

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Managing Risk: Take a Page From the Pros

Metrics' cold, calculating method for balancing folios' risks and rewards. BY LEWIS BRAHAM

ASK ANY money manager what separates the pros from novice investors, and he'll whisper two words: risk control. The experts know y how much they expect to make investment but how much they ssibly lose. Yet most 401(k) in- s just think of the upside when ut their money into different mu- nds. If they do think of the down- is only in vague, undefined terms. ou're not willing to risk losing money, chances are you'll never enough to retire. A basic tenet of al markets is that investors are ed for the risk they take. Stocks, are more volatile in their price ents than bonds, have outper- bonds over the past century. , you have to take risk, but how quantify it? RiskMetrics Group, y the in-house risk-management J.P. Morgan, has developed tools s-test individual investor portfo- t are similar to those used to an- sk for its blue-chip clients, such as s Schwab, Goldman Sachs, and, se, J.P. Morgan Chase. (These e available at the firm's free Web iskGrades.com.) Such "value-at- nalysis is not without its critics. g complaint: it ignores any quali- insight an adviser has to offer he portfolio's individual securities fund managers. But it can help derstand your exposure to loss.

1(k) CHALLENGE

stem works like this: For every holding in a portfolio, RiskMetrics assigns a RiskGrade, a measure of the maximum likely move that a fund or stock could make in a year, based on its historical volatility. The grades range from 0 to 1000, with 100 being the long-term average for all stocks. To calculate the loss/gain potential, you divide this number by five. So a 100 RiskGrade represents a 20% potential annual loss, or gain if the volatility works in your favor. A 1000 grade would reflect a 100% possible loss and a 200% possible gain and would only apply to extremely leveraged portfolios.

How would RiskMetrics analyze the typical 401(k) participant's portfolio? Of course, every investor's situation is different, but many people share similar 401(k) investment options and retirement goals. So *BusinessWeek* asked RiskMetrics to create portfolios with the 10 most popular 401(k) funds offered through the largest fund families, Vanguard Group and Fidelity Investments. (The funds were selected based on assets and availability in as many retirement plans as possible.) We also asked the firm to include a generic stable-value fund and a company stock offering, which are found in many 401(k) menus.

NO FAVORITES

The portfolios were for investors in three age groups—40, 50, and 60—and for each, RiskMetrics established a target RiskGrade, assuming the person would cash out at age 70. Analyzing the historical returns for taking on various risk levels, RiskMetrics projected that the 40-year-old with a 75 RiskGrade portfolio would earn a 9% annualized return; lowering the grade to 50 at age 50 would earn 7%; and the 60-year-old with a 25 RiskGrade would get 5%.

Such projections are standard for asset-allocation plans. The difference here is that RiskMetrics calculates expected returns for any given fund based on its RiskGrade, which is derived from its share-price volatility over the past six months. Such short-term data have proved more effective at predicting future volatility, the company has found, because it captures the risk characteristics of a fund's portfolio today, not two or three years ago when it may have had different holdings. In fact, half the RiskGrade is derived from the past eight days' price movements.

RiskMetrics also ignores any performance edge a portfolio manager may have had over an index. In other words, if a manager's fund was just as volatile as the Standard & Poor's 500-stock index, which currently has a RiskGrade of 88,

but the manager beat the index, RiskMetrics would not overweight the fund in the portfolio. "There is no empirical evidence that the majority of fund managers who have outperformed an index in the past can continue to outperform that index," says Michael Thompson, a market strategist at RiskMetrics.

RADICAL DEPARTURES

Such an assumption leads to radically different conclusions than a qualitative analysis of Vanguard's and Fidelity's funds would. For instance, RiskMetrics recommends that 25% of a 40-year-old Vanguard investor's portfolio be in Vanguard U.S. Growth Fund, a large-cap growth fund. This fund has had a terrible performance record recently. Meanwhile, Vanguard Primecap Fund, a large-cap growth fund with excellent returns, gets only 10% of assets. The reason: U.S. Growth has a RiskGrade of 97, higher than Primecap's 92, so its expected return is greater, as is its risk of loss. But Thompson says a 40-year-old's time horizon is long enough to benefit from higher risk. "Our research shows you need 10 years to ride out a bad market," he says.

Experts who know the managers of these funds disagree with Thompson's analysis. "Vanguard U.S. Growth is a dog fund that has gone from bad to worse," says Daniel Wiener, editor of *The Independent Adviser for Vanguard Investors*. For a 40-year-old, Wiener would put 50% in Vanguard Primecap, his favorite in the fund family.

RiskMetrics also chose Vanguard's and Fidelity's S&P 500 index funds because the firm assumes active managers with similar RiskGrades and strategies will not be able to beat the index after costs. Wiener disagrees with this stance, as does Editor Jim Lowell of the *Fidelity Investor* newsletter. "Fidelity's strength rests on its managers' abilities to outsmart the market," Lowell says. "With Fidelity's Contrafund, Low-Priced Stock, and Diversified International funds, you have a trinity that can trump any index."

RiskMetrics' analysis goes beyond individual funds, however. It also calculates how the funds interact with each other to reduce the risk of the overall portfolio. For instance, a bond fund

Stress-Tested Portfolios

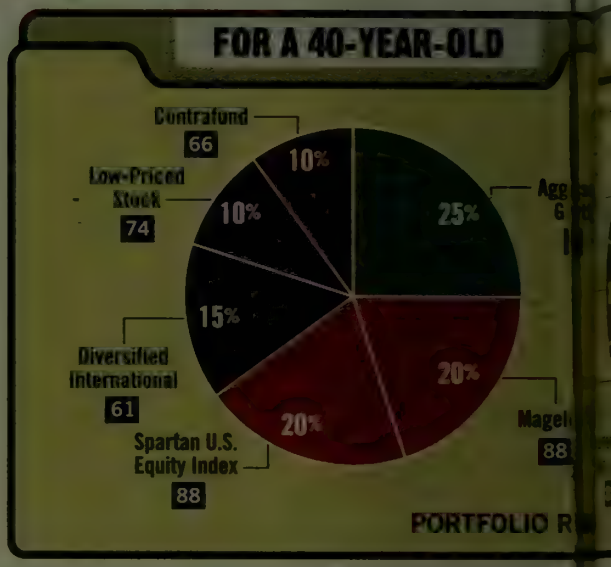
Starting with the most popular 401(k) fund offerings at Fidelity Investments and Vanguard Group, we asked RiskMetrics, a financial advisory company, to design three portfolios. RiskMetrics assigns grades from 0 to 1,000 for funds based on volatility—the higher the number, the more volatile the fund. The RiskGrades for the portfolios are not the averages of the individual funds, since diversification lowers risk. Also important: You won't find money-market funds, stable-value funds, or company stock in these portfolios. RiskMetrics says money and stable-value fund returns are too low, and company stock is too risky.

RAW MATERIALS

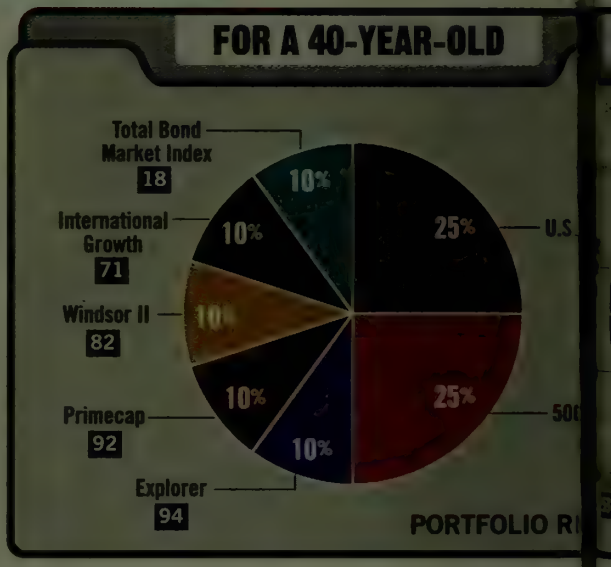
- Large-Cap Growth
- Large-Cap Blend
- Large-Cap Value
- Mid-Cap Growth
- Small-Cap Growh
- Small-Cap Value
- Domestic Hybrid
- Bond
- Foreign

Risk Grade

FIDELITY FUNDS



VANGUARD FUNDS



MAN VS. MACHINE

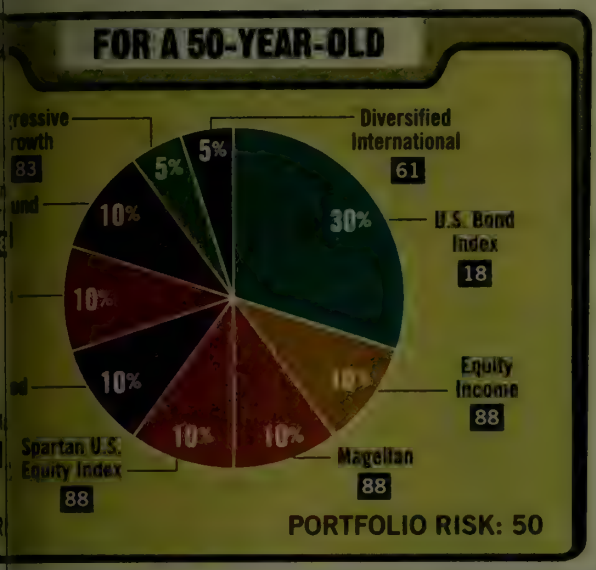
In setting up an investment portfolio, some people prefer quantitative methods that use computer models to pick stocks or funds. That's what RiskMetrics does. The other view is more hands-on, with advisers selecting investments based on past performance or managers' track records.

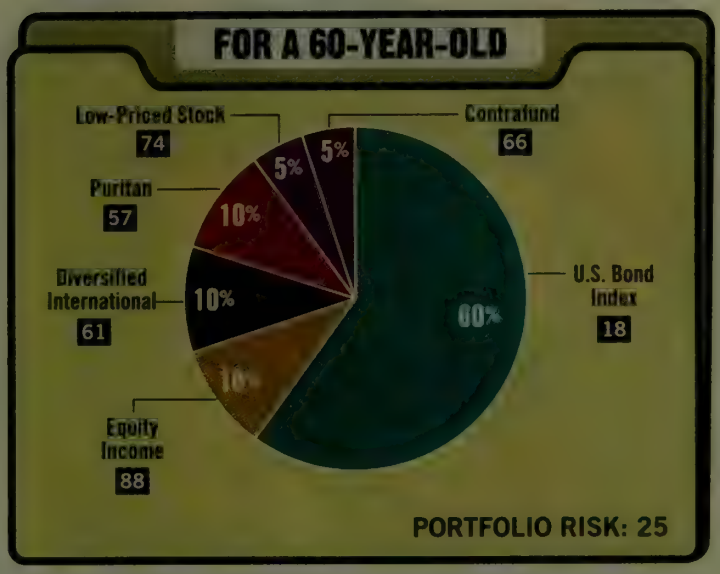
RISKMETRICS SAYS:

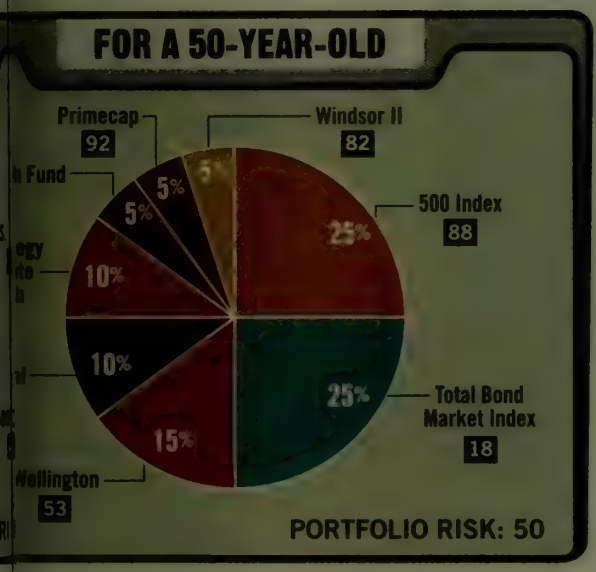
- ▶ In an efficient market, fund managers add little value, so use index funds for a good portion of your portfolio
- ▶ Bonds offer better returns than cash and stable-value funds
- ▶ Owning employer's stock is dangerous
- ▶ Recent volatility is a good indicator of near-term returns

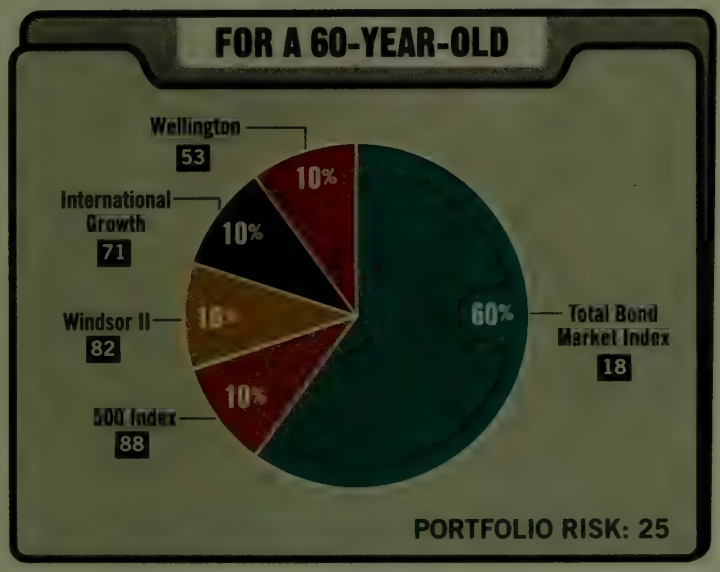
ADVISERS SAY:

- ▶ The market isn't efficient, and that's why a smart fund manager can beat index funds
- ▶ Bonds are overvalued and should be reduced in your portfolio
- ▶ Owning employer's stock is dangerous
- ▶ Take funds' long-term performance into account









hen a stock fund falls and vice Combined, they may be less than if you invested in them in- ally. So if you calculate the ed average of all the RiskGrades se portfolios you will find that it equal the portfolio's grade. To re the value of its allocations, etrics assigns a Diversification score to the portfolio, indicat- w much the average RiskGrade is d by this particular allocation.

portfolios with the greatest di- cation benefits were for the 60- ds, a RiskGrade reduction of 16 nguard's and 13 for Fidelity's in- from a weighted average of the grades. (So without the benefit, rd's and Fidelity's RiskGrades for year-old would be 41 and 38, respectively.) The reason is that the heavy bond allocations greatly reduce the risk of more volatile stocks, while even a sliver of equity improves the risk-adjusted returns of a bond-heavy portfolio. In the 40-year-old's portfolios, there is less risk reduction because the funds, although different, are primarily invested in stocks, which move somewhat in tandem, regardless of style.

THE UNTOUCHABLES

Curiously, RiskMetrics recommended no allocation to an employer's stock or to money-market or stable-value funds. In the case of company stock, there is "concentration risk," says Thompson. Without the risk-reducing benefits of diversification, the average stock currently has a RiskGrade of 146. But even if your particular company had a lower grade, Thompson doesn't recommend owning it. "You might think you're working for the greatest company in the planet, but a lot of people thought Enron was the greatest company on the planet," he says. By contrast, cash and stable-value funds were too low-risk and low-returning.

Once you've designed your portfolio, it's important to keep track of its risk level. Sometimes a major event such as Enron's collapse can cause the risk profile to soar. At such times, it is best to not make any knee-jerk changes. But be aware of how much you could lose if the heightened volatility continues. This way you'll know whether to stay the course or to reduce your risk. Then you'll be as smart as many of the pros. ■

Home, Sweet Pot of Gold

Is it time to lock in profits from your house?

BY SUSAN SCHERREIK

EMPTY NESTERS rattling around in a big old house may find it's a tempting idea. Sell the family manse now—even if you aren't ready to retire—to lock in juicy profits before the housing bubble bursts. Then buy a smaller place or rent for a while until you decide when and where your next move will be.

"This can be a great strategy for people who bought their home in, say, 1980 for $150,000 and can sell it for $700,000 today," says Robert Reby, a financial planner in Danbury, Conn.

Timing the housing market is no easier than calling the top of the stock market. If you sell now and your house goes up $50,000 more over the next six months, you may kick yourself for acting too quickly. If you decide to rent while you wait for housing prices to soften, you'll probably face stiffer mortgage rates when you return to the market.

Still, housing prices in many parts of the country are so high that pre-retirees ought to at least consider a sale. The biggest plus is that a capital gain of up to $500,000 on your primary residence is tax-free. (Halve the amount if you're single.) You can use the exemption as often as you like—as long as you live in a house for at least two of the most recent five years. That means if you downsize to a condo—even if it's just a few miles from where you live now—you don't lose out if real estate prices continue to appreciate and you sell again when you finally do retire.

You're mostly likely to win if you live in an area where home prices have surged 40% to 60% or more over the past few years, as they have in parts of California, Florida, and the Northeast. Real estate in these areas is so overheated that a hike in mortgage rates of more than one percentage point could cause home prices to fall, says Mark Zandi economist at Economy.com.

Since a home is more than a m vestment, lifestyle should be a consideration. A year ago, An Tim Mygatt, both 63, sold the fo room colonial in Katonah, N.Y had owned for 28 years even they had no plans to leave th "We needed to change our life says Anne, who still sells real while her husband is a retired e ecutive. The couple opted to r airy waterfront house on Cand Lake in nearby Danbury, Conn.

Anne Mygatt admits another she sold is because she thought t estate market was peaking. Bu though her house, which she bou $92,000 and sold for nearly $7 has since gained an additional $1 in value, she doesn't regret the sion because she and her husband ed a change. Now, the two are back into the local market. Re they purchased a four-story luxur do in Danbury for $455,000.

Buying works for the Mygat cause they plan to stay in the But if you think you may reloc three years or less, it's better t Depending on where you live, th ker's commission for selling your can run 5% to 6%, and you'll lawyer's fee and closing costs.

Renting buys time so you can out where you w ultimately settle the last years befo tiring, couples oft cation in Florida zona, and other r to see if they'd l live there," says Lifson, a New Yo countant. "With money sitting i bank, you'll be a move quickly if th fect buying oppor arises."

A home is pro your biggest asse also your refuge. why your decisi sell now—or later must be based on tical as well as em al issues. By thi about all the im tions before you ta tion, you'll avoid h any regrets.

THE MOST OVERPRICED HOME MARKETS

This survey is based on real estate consultant John Burns's analysis of housing affordability in major metropolitan areas compared with historical averages. A rating above 5 means that costs have outstripped income growth. Burns considers ratings of 7.5 or more to indicate a market bubble with a risk of bursting.

CITY	SCORE*
Boston	9.0
Fort Lauderdale	6.2
San Diego	5.9
Miami	5.9
Orange County, Calif.	5.8
New York	5.7
Sacramento	5.3
Oakland, Calif.	5.3
San Francisco	5.2
Riverside, Calif.	5.2

Data: John Burns Real Estate Consulting Inc.

Retired—
...b a New Job

...king later in life yields rewards more valuable than money. BY CHRISTOPHER FARRELL

FORGET leisure. Retirement is increasingly regarded as a transition to another work life, although at a more relaxed pace. In 2000, 37% of men and ...f women age 55 to 64 were em... full- or part-time while receiving ...n income, according to investment ...TIAA-CREF. Those proportions are ...to go higher. And 8 out of 10 ...oomers say they plan to work in ...ment, according to the AARP, the ...t for the over-50 crowd.

...movement toward embracing ...during the last third of life calls ...uch broader definition of investing ...irement. The typical retirement ...eet deals with financial assets such ...ties, bonds, cash, and real estate. ...vesting for the long-term should ...compass education, training, and ...king—what economists call human ... Economists estimate that human ... is the most important form of ... in the U.S., worth three ... times as much as all oth...s, including stocks, bonds, ...l estate. "Investing in hu...pital is an investment like ...er, and you can make it ... stage in life," says Zvi ... professor of finance at ... University.

GROWTH SPURT: Former social worker Thompson volunteers at a botanical garden

...return on investment? Working ... can make a huge difference in ...ment living standards. Pocketing ... slim income often allows retire...portfolios to compound over a ... period of time. For example, a ...0 portfolio at age 55 compound...ually at a 5% rate with a $1,000 ...ution a month is worth around ...0 at age 60. But if earning an ... means the portfolio is left alone ...ound at a 5% rate until age 65—...ith no new contributions—it will ... around $738,000.

... than making money, working is ...lly and mentally energizing. Carol Thompson was a licensed clinical social worker, working with private patients and for the courts in the San Francisco Bay area. Her work was rewarding, but draining, and after several decades she looked forward to leaving it behind.

Then what? She took years to close down her practice, but wanted something else to do. One day, while strolling through the Botanical Garden of the University of California at Berkeley, she noticed a call for volunteers. She signed up—and started taking horticulture courses at Oakland's Merritt Community College. Now, she's a knowledgeable, valued volunteer working with professional botanists on plant propagation. "There is something stimulating, but humbling, about starting something new," she says. "It's really an anti-Alzheimer's thing to do."

Whether you work for pay or pleasure, plan for it. A common strategy for retirees is to consult part-time for their old company. And community colleges can be good places to acquire some new skills and training, as Thompson discovered. About 15% of community college students are 40 or over.

Many retirees are eager to work by volunteering or taking a job at a local nonprofit. But good intentions and a willing spirit aren't enough to get a fulfilling job. A smart investment of your time is to network at the nonprofit long before you retire. Otherwise, you might get stuck with boring tasks that don't take advantage of your talents.

In many cases, retirees build on their existing human capital. Henry Camp-

bell, 59, labored for 23 years in the pharmaceutical industry, often managing research departments. Tired of the business, he thought about turning his passion for food and wine into a new career. Downsized out of a job in 1996, he enrolled in the Restaurant School in Philadelphia and studied restaurant management. He has run several restaurants since graduating in early 2000. "I'm still using my management skills," says Campbell. "I think that's one of the key strengths I am able to bring to a restaurant job."

So, while struggling to put money aside for your later years, dream about what you would like to do in the next stage of life. Once you're drawn to an idea, invest in the skills and contacts you'll need to bring that dream to life. ■

INVESTING IN YOURSELF

Here are Web sites that can help you prepare for retirement by brushing up skills acquiring new ones, finding work, or becoming a volunteer.

■ **WWW.AACC.NCHE.EDU** Run by the American Association of Community Colle it will help you locate an institution with the courses you want.

■ **WWW.AARP.ORG** The giant organization for people over 50 devotes much of i useful Web site to work and volunteering information.

■ **WWW.EXPERIENCECORPS.ORG** This nonprofit organization looks for volunte 55 and older and connects them with children and teens. The focus is on helping youngsters improve their school work.

■ **WWW.SBA.GOV** Eager to shed the mantle of employee and become an entrepre late in life? The Small Business Administration is a valuable resource.

■ **WWW.EXPERIENCEWORKS.ORG** Experience Works acts like a staffing agenc older Americans to find everything from temporary work to full-time employment well as training.

Q&A

Zvi Bodie: Sleep Soundly Without Stocks

Conventional wisdom says buy stocks to save for retirement. Not necessarily so, says **Zvi Bodie**, a Boston University finance professor and co-author of *Worry-Free Investing* (FT Prentice Hall; $24.95). Bodie advocates risk-free investments, such as the U.S. Treasury's TIPS and I-Bonds. These are regular government bonds and savings bonds, respectively, that keep pace with inflation. Bodie recently spoke with Personal Finance Editor Anne Tergesen.

Are people taking on too much risk?

People who have been following conventional investment advice are probably taking more risk than they should and don't even know it. They've been told not to worry about the stock market going down because, in the long run, stocks are going to beat everything else. That's a fundamental fallacy.

How risky are stocks?

The probability that stocks will perform worse than risk-free investments, such as TIPS or I-Bonds, gets smaller the longer you hold them. After 30 years, there is a 95% chance that stocks will beat TIPS. But the severity of a possible shortfall gets bigger. For example, say you have $500,000 and are three years away from retirement. If you suffer three years of 15% losses, your savings will be almost cut in half—and your retirement will be jeopardized. Of course, the longer the string of losses continues, the larger the shortfall will be.

How do you assess risk tolerance?

Age should not be the first consideration. Instead, you r assess how much risk your career exposes you to. If you stockbroker or are starting a business that you intend to public, your income is very vulnerable to a stock market decline. Without investing a dime of your retirement sav the market, you already have a huge exposure to stocks

Should most people avoid stocks?

Some people should be investing in sto you work for a large company and your are transferable, your career is pretty w insulated from the market. But those w invest in stocks should do it in a sensib that keeps the consequences in mind. example, you've got to be willing to pos retirement if you fall short of your goal.

What investments do you recommen retirement savings?

If you want to be worry-free, take care your basic goals—such as securing a standard of living in retirement and providing an education for your childr use TIPS and I-Bonds. Unless you are wealthy, make sure you have enough invested in those safe assets to meet needs. Once you've taken care of the you really care about, you can afford take a flier [on stocks].

BusinessWeek online

For an extended version of this interview, www.businessweek.com/magazine/extra.

Planning at Your Fingertips

e software programs help you figure out your s under different scenarios. BY ELLEN HOFFMAN

TO GET A retirement plan from a professional adviser, you can spend upwards of $1,000 for all but the simplest version, and hundreds more a year for updates. But if omfortable with the three C's—ers, calculations, and (financial) s, you can use planning software ction of the cost.

learn a lot from playing with ware, since the better programs let you experiment with a range of scenarios and update your plan whenever you choose. The downside is that "retirement planning is a complex process, and there is no perfect program," says Eric Sondergeld, director of retirement research for LIMRA International, a consulting firm based in Windsor, Conn.

Sondergeld reached this conclusion after heading up a 2002 study sponsored by LIMRA and the Society of Actuaries (SOA). The study analyzed more than a dozen planning programs designed for consumers. Among the defects it found: Programs failed to factor in home equity when evaluating retirement assets or assumed users could make intelligent guesses about how long they'll live or future inflation rates.

The basic goal for all the programs is the same: To create a plan that'll generate enough income to support you for the rest of your life. Where they differ is in their approaches. Some require detailed estimates of your current and future expenses, while others simply ask you how much income you will want to live on.

Since the study, some titles are no longer available, and new ones have appeared. To identify the better ones on the market, I conducted my own review of downloadable programs (some of which come in CD-ROM versions) that were both comprehensive and easy to use. I found four worth considering. Here they are in order of my preference.

■ **Retirement Planner 2003** (torridtech.com; $39) lets you plug in and retrieve lots of useful information very, very quickly, using four colorful, interactive screens. The "retirement savings" screen requests your current and expected retirement ages, data on your tax-deferred and taxable investments, and estimates of future Social Security and pension income.

This produces spiffy graphics that demonstrate exactly how your savings would wax or wane year by year, for the rest of your life under varying assumptions such as the returns on your investments. An equally vivid second screen, based on the same data, shows your potential annual retirement income on a similarly interactive graph. Two other screens are spreadsheets that track your savings, income, and progress toward your goal and let you keep records of your investments. The "settings" button helps you estimate your Social Security and pension income, and navigation in general is smooth.

The negatives are that the program can neither factor home equity into calculations, nor create separate financial tracks for each member of a couple. But it's useful if you want to see, quickly and dramatically, whether your current retirement plans will take you anywhere near your ultimate financial goal.

■ **ESPlanner** (esplanner.com; $199 for basic version) gives the most flexibility in figuring retirement income and expenses and is the most comprehensive. But if your finances are complex, it could take hours to complete your plan.

Like most programs, it includes Social Security, pensions, 401(k)s and individual

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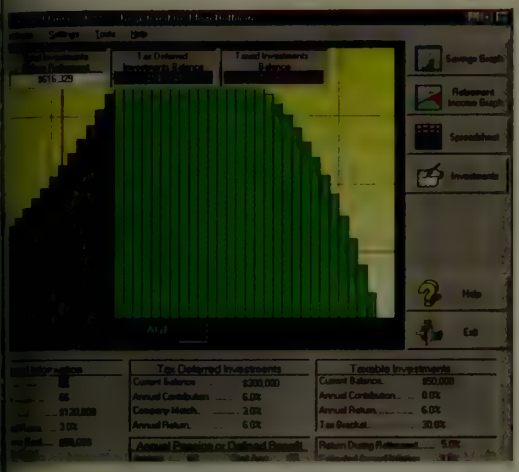


of financial data to generate up to five financial scenarios for retirement. Based on your personal information and on your assumptions about 12 economic factors, such as inflation and investment returns, the scenarios offer year-by-year income estimates.

This program is for green-eyeshade types who have the patience to enter lots of data and continually update the numbers. The program comes with a printed manual and an easy-to-use help section.

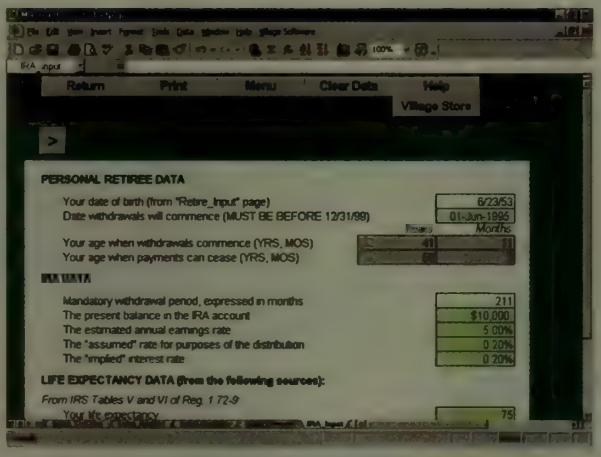
EMENT NER

graphics how your s would wane

retirement accounts, and other investments in estimating income. Much to its credit, it also factors in real estate—the biggest asset for many. It asks for the value of the equity in your pri- nd vacation homes and analyzes blications of selling any e or of relocating to an- tate. It also helps you tand how "special ex- res," such as a wedding ge, might affect your ent stash.

l to use a beta version nner, and had quite a blems with navigation. velopers say they ex- bug-free version to be e on Sept. 1. ESPlanner which includes "Monte simulations that offer l guidance based on the lities of different scenarios be- l during retirement—costs $249.

thWhen (wealthwhen.com; $99.99) ou to manipulate a vast amount



■ **Retirement Planner FastAnswer** (villagesoft.com; $69.95) is a Microsoft Excel spreadsheet program that treats your total retirement income, including potential home sale proceeds, as an annuity. By adjusting for different inflation rates, investment returns, and payout scenarios, you'll see how long your "annuity" lasts. It lets you work out IRA withdrawal options and compare the effects of taking money out of retirement accounts as a lump sum vs. installments.

RETIREMENT PLANNER FASTANSWER: It treats your retirement income as an annuity

The program has kinks. The "help" information is on one screen instead of linked to a question. Click on the "clear data" button, and you erase all your inputs, not just what's on that page. Some screens lack a menu button, so it's hard to return to a previous section. If you want to add detailed 401(k) income calculations, you'll need to spend $69.95 for 401(k) Forecaster FastAnswer.

Whatever program you use, watch out: You may convince yourself you've got definitive answers to your retirement questions when all you've got are educated guesses. Still, that's all you may wind up with even if you pay a planner a whole lot more. ■

Web Solutions

Web offers scores of retirement ulators, but few sites where you stematically construct a financial . These two are fairly thorough:

central.msn.com/retire/planner.asp
you measure your risk tolerance ect appropriate investments. The plan" costs $20 and consists of nent recommendations.

n.com/retirement/planner
nancial info for yourself and your . If your plan won't produce enough you can make adjustments until the desired result.

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The Trickiest Part Of Retiring Early

Think you have enough cash to stop working before age 65? You'd better have a separate treasure chest for health insurance. BY ELLEN HOFFMAN

EVEN IF you have enough income to take early retirement, you can't say good-bye to your co-workers unless you've secured health insurance that will bridge the gap between the day you leave work and the day you turn 65 and qualify for Medicare.

That coverage does not come cheap. A 2002 study by the Health Insurance Association of America, a trade group, collected data on more than 220,000 individual health insurance policies for people age 50 through 64. The average annual premium ranged from $2,749 for one person in the 50-to-54 age group to $3,642 for those in the 60-to-64 range.

Why so much? A big reason is that most private insurance is "age-rated," says Mila Kofman, an assistant research professor at Georgetown University's Institute for Health Care Research & Policy in Washington. "As you get older, even if you are healthy, you are still rated based on whatever the insurance company determines the risk to be if your age is 50 or 55 or 60," she says.

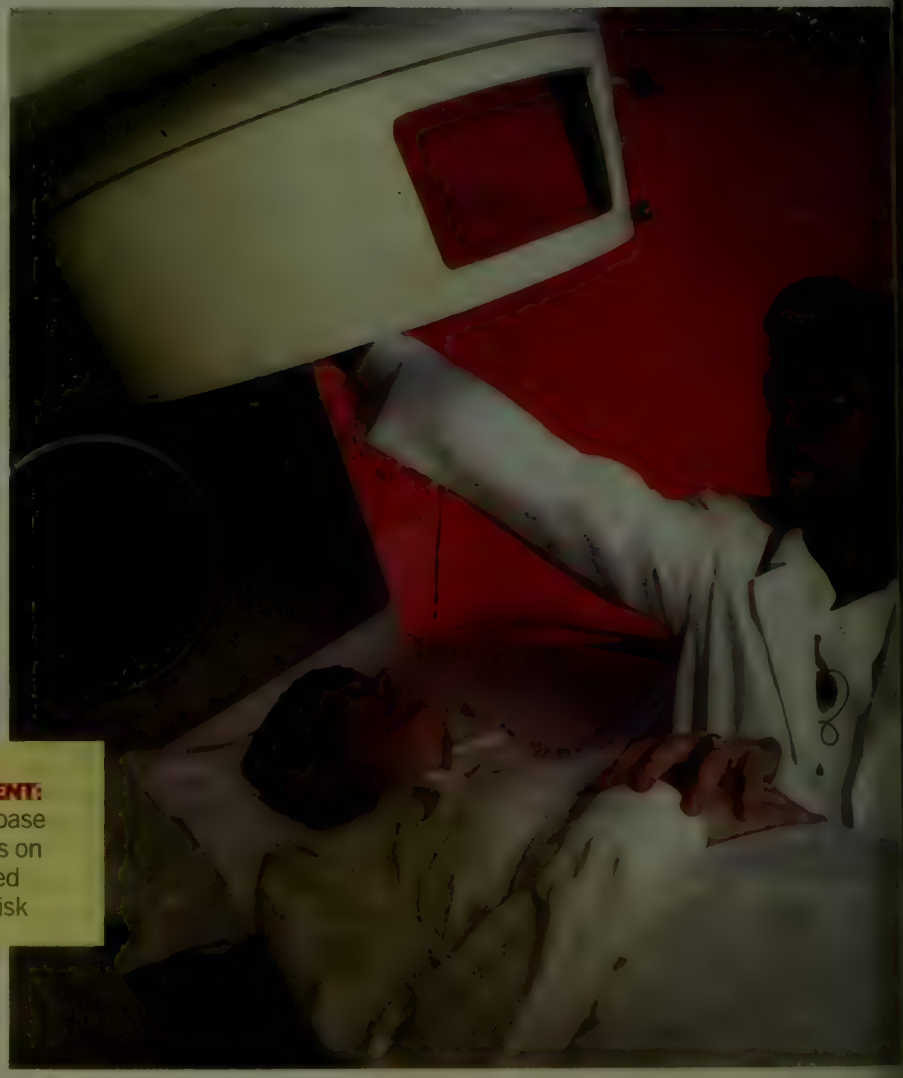
THE FINE PRINT

It's even worse if you have a preexisting condition, as Gwen Bridgeford, 59, a senior human-resources specialist for a research foundation in San Antonio, found out. A breast-cancer survivor, Bridgeford would like to retire soon but hasn't been able to find acceptable insurance. "If you ever had a stroke, heart attack, or cancer—that just rules you out" of many policies, she says.

The first place to check for coverage for early retirement is with your employer. One form of employer insurance is COBRA (which stands for the Consolidated Omnibus Budget Reconciliation Act that provides for this sort of protection). Under COBRA, retirees can continue their employee plans for 18 months. But they have to pay the full cost—including the share their employers previously picked up—not just what they paid as employees.

Policies that employers offer cally to retirees are becoming a able option as more companies them. The Employee Benefit R Institute reports that in 2000, o of private employers were offer erage to retirees younger than 6 from 22% in 1997.

If employer-related coverage work for you, start searching



CANCER TREATMENT: Insurers base premiums on age-related average risk

LARRY MULVEHILL/PHOTO RESEARCHERS INC.

of your options—except some policies—will be offered by com- that are licensed within your nd the type of coverage and cost ry widely. What's more, each as its own rules on issues such as ting conditions and how premi- e calculated. To learn what ap- you, go to healthinsurancein- a consumer Web site.

, scope out the universe lable plans. You'll save y contacting an agent or who represents many in-

Or you can go to aic.org, the Web site of tional Association of Insurance ssioners. There, you can locate ate insurance office and contact tly for a list of licensed compa- lso, click on the NAIC Consumer ation Source to read about the nd number of complaints that en filed against insurance com- in each state. Other sources are nprofit State Health Insurance ling & Assistance Programs n every state, which you can find through www.medicare.gov; and ehealthinsurance.com, a commercial Web site that acts as an agent for many insurance companies.

The ehealthinsurance site is easy to use. Enter your age, sex, and zip code, and you'll get a list of insurance policies for which you might qualify. In each case, you can see the amount of the premium, the type of coverage—a regular indemnity plan, a preferred-provider network, a health maintenance organization—and basic deductibles and co-payments. Want to know more about a plan? Contact a local agent or broker for that company. The Web site sells insurance, but consumer advocates say that it's better to buy a policy from someone you can talk to directly and hold accountable if something ends up going wrong.

You get no additional benefits or premium discounts for a lifetime of robust health, but "a stroke, heart attack, or cancer—that just rules you out" of many policies

Another route is to pursue group policies, which are sold to residents of a number of states. They're available through what are broadly referred to as "associations," such as a professional or trade organization, or an alumni group. However, Gail Shearer, director of health-policy analysis for Consumers Union, suggests that you tread carefully, because many of the multistate association plans are chartered in states with the least regulation—which could be less than what you would get in your home state.

Since the hunt for early-retiree health insurance can be difficult, allow yourself ample time. You may be stuck at work a little longer, but it's better than entering into retirement exposed to today's exorbitant medical costs. ■

Until You're Old Enough for Medicare...

E	WHAT IT IS	PROS	CONS	FOR MORE INFORMATION
	Receive current employer group coverage for 18 months after leaving job; 36 months if divorced spouse of employee.	Guaranteed access unless you leave job for "gross misconduct." No problem qualifying if you have preexisting medical condition.	You pay total premium, including employer's share. Businesses with fewer than 20 employees are not required to offer this coverage.	www.dol.gov and search for "COBRA."
	Health-care plan specifically for that company's retirees.	May be more economical than alternatives.	Employer can cancel the plan. Most plans have age and length-of-service requirements. Cost to insured is rising.	www.consumer.gov/health.htm, scroll down to "insurance," click on "Can Retiree Health Plan Benefits be Cut?"
	State-regulated coverage that the feds require be offered to people who can't secure insurance privately and who were previously covered for at least 18 months.	May be the only source of coverage for some people, especially those who are ill.	Likely to be very expensive.	healthinsurance info.net to learn how it works in your state.
	Policy purchased in the private market.	Choose the type of coverage desired—indemnity, PPO, catastrophic—including providers that are acceptable to you.	Probably expensive. Preexisting medical conditions may disqualify you. In some states there are few policies to choose from.	ahcpr.gov/consumer/insuranc.htm, scroll down to "individual insurance."
	Coverage you qualify for by joining an organization, such as a professional or alumni association.	Premiums may be lower than for individual policies in the private market.	May have fewer benefits or protections than required of policies licensed in your state. Information on coverage and insurer's financial health may be hard to get.	To locate your state health insurance office and complaint reports, go to www.naic.org, the site of the National Association of Insurance Commissioners.

SEAGATE: IS THE TIDE STILL RISING?

BY ROBERT BARKER rb@businessweek.com

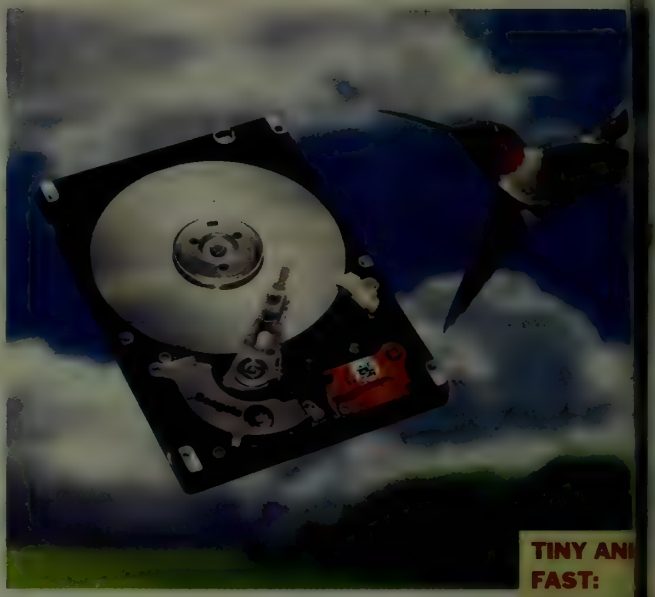
TALK ABOUT DRIVING A HARD BARGAIN. Back on Nov. 22, 2000, as the Silicon Valley-Wall Street edifice was shaking in a way that left the Bay Area nostalgic for the 1989 earthquake, a group of private equity firms stepped up to take Seagate Technology private. The buyout valued Seagate, a veteran of the computer hard-disk-drive wars, at a bit over $1.8 billion.

Two years and 19 days later, Seagate came public again at $12 a share, revaluing the company at $5.5 billion. Its backers, including Silver Lake Partners and Texas Pacific Group, wound up recouping their entire original investment—while keeping 82% of Seagate. Nice work if you can get it.

Now, seven months farther down the road, the private equity boys await one more payday. They hope soon to sell an additional 60 million Seagate shares in a secondary offering led by Morgan Stanley. If the shares go at Seagate's recent price above $20 a share, Seagate's backers will take home $1.1 billion or so—and still hold 68% of the stock, worth about $6 billion. Along with unremitting envy, all of this engenders in me one question: Can any up-side be left?

The answer, improbably, may be yes. While the easy money is long gone, Seagate at $20 is no lunatic's proposition. I say this first because, although Seagate's market value now tops $9 billion, it remains a ghost among individual investors: Neither Morningstar, nor Standard & Poor's, nor Value Line follows the stock. Each of these research services tracks Seagate's leading, yet far smaller, publicly traded rival, Western Digital. Eventually, the disparity will be resolved, focusing more investors on Seagate's position—and potential.

More important, business at Seagate is pretty good today and likely to get better tomorrow. Revenue in fiscal 2003, ended June 27, grew to $6.5 billion, up from $6.1 billion in fiscal 2002. Net income jumped to $631 million from $153 million, in part because consolidation led to slower price-cutting. With a 29% share, Seagate already is No. 1 in the overall market for hard-disk drives, but it remains ambitious. It aims to get more Seagate drives into such increasingly popular consumer electronics as video recorders, and it now is rivaling Western Digital as a supplier of drives for Microsoft's Xbox. In June, it also introduced Mom a 2.5-inch drive for notebook computers, a new arena f gate. This time next year, it hopes to have a 10% sh that market.



TINY AN FAST: Momentu entering hot mark

As you would expect, others stand in its way. I Global Storage Technologies (HGST), formed this yea Hitachi and IBM merged their hard-disk-drive units, leader in notebook drives. Bill Healy, who is in charge part of HGST, wonders whether any rival, absent a le ward in technology, could steal that much share tha Just the same, Momentus could prove unusually benef Seagate. That's because, unlike most corners of the dis world, where price-cutting is the norm, HGST in May ly hiked prices an average of 5% on its 40-gigabyte, 2 drives. Healy told me the higher prices have stuck had no significant orders cancelled," he said. "Our busi running extremely strong, even after that price inc This figures to raise a price umbrella over Momentus

What about the gigaprofits already taken by Se private-equity investors? Is there more to reap? If har pressed, Seagate's valuation still strikes me as moder $20, the stock goes for 13 times the company's estimate cal 2004 earnings. True, that is a higher multiple than ern Digital's 12, but Seagate is much larger, and each d sells brings in more revenue and profit than do We drives (table). The stock also trades at a discount Standard & Poor's 500-stock index, which commands 17 the next 12 months' earnings. Whose prospects look now, the broad market's or Seagate's? Seagate's.

DUELING DISK-DRIVE MAKERS

COMPANY/SYMBOL	STOCK PRICE*	2004 EPS	REVENUE MILLIONS	PER UNIT SHIPPED REVENUE	PER UNIT SHIPPED OPERATING PROFIT
Seagate Technology STX	$20.65	$1.55	$6,406	$96.80	$6.97
Western Digital WDC	12.67	1.02	2,579	69.33	4.72

Income and operating data for 12 months ended in March, except earnings per share, which are estimates for the fiscal year ending next June

*July 15 closes

Data: Company reports, Standard & Poor's, *BusinessWeek*

They both work at the
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Have the
same six-figure salaries.

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early
retirement,

while the other looks forward to
the 15th and the 31st?

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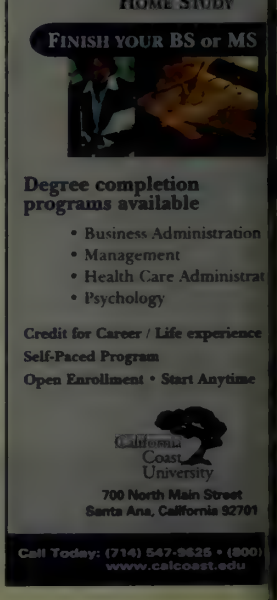


A SPIN-OFF JUST MIGHT SPIN GOLD FOR THREE-FIVE SYSTEMS.

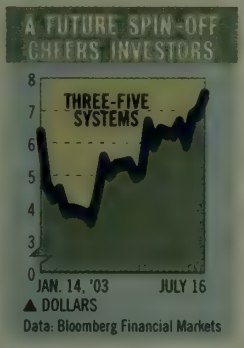
RELIEF FOR DOW CHEMICAL'S ASBESTOS PROBLEMS IS IN SIGHT.

THE ONLINE AD BOOM BOOSTS 24/7 REAL MEDIA'S PROSPECTS.

ENE G. MARCIAL

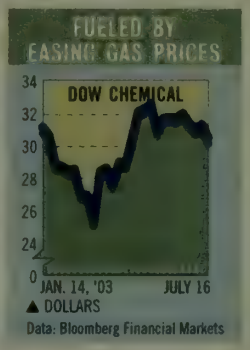
Three-Five a 10?

n impending spin-off is lighting a fire under the stock of tech wreck Three-Five Systems (TFS). Once a high-flier that traded at 82 a share in mid-2000, Three-Five crashed to earth when the bubble burst, diving to 3.47 by Oct. 9, 2002. The s since more than doubled, to 7.35. Part of the reason: ast, Three-Five expects to spin off to shareholders its unit, which operates microdisplay systems that permit , high-performance display in a ze. Its "liquid crystal-on-silicon" gy could fit all the info on a PC n a microdisplay no larger than nail. Some pros believe the spin- eases Three-Five's value. (Each lder gets one share of Brillian y four shares of Three-Five). ces of Three-Five will be worth n what the stock is now trading s Joseph Cornell, president of Advisors, which analyzes spin- mergers. The spin-off frees Three-Five from funding which, he notes, would be a viable outfit on its own. ive will then focus on newly acquired assets. It makes play modules used in cell phones and wireless handsets panies such as Motorola. An overcapacity in handsets es, pushing Three-Five to acquire new assets. Cornell hat six months after the spin-off, the stock could be 0 to 15. Spin-Off analyst Lee Kaplan says Brillian ll at 3—and then pop to 5 three months later. Kaplan ee-Five breaking even in 2003 on sales of $170 million.



Dow Chemical uld Be a Buy

ong-awaited relief may be around the corner for Dow Chemical (DOW). Although its stock has leaped from 25 in mid-March to 30 on July 16, the Street is far from convinced that the largest U.S. chemical company is out of the woods: Of the 14 nalysts who track Dow, only four rate it a buy. As- abilities and surging oil and gas prices that fuel high- tock costs have become a double whammy. But some nk it's time to buy: "We expect Dow Chemical will get elief soon from these issues," says Earl Gaskins, man- rector at Brandywine Asset Management, which owns nearly 300,000 shares. He puts Dow's worth at 42, plus a 4% dividend yield. He's optimistic about Dow's asbestos problem, since the Senate is moving forward with a $108 billion fund for victims. Dow's woes stem from Union Carbide, bought in 2001, which once made products containing asbestos. Gaskins argues energy prices will drop later in the year as demand projections don't support current prices. Indeed, natural gas prices, which had soared, are easing. He also sees more supply from Russia and elsewhere. Chemical prices, he adds, will rise as the economy picks up. Consensus estimates are 96¢ a share for 2003 and $2.08 for 2004. Gaskins sees Dow earning $5 in 2005. Prudential Securities' Andrew Rosenfeld says 2004 will be a transition year for chemicals as demand begins to catch up to oversupply. He rates Dow a buy.



A Net Stock Rises from the Ashes

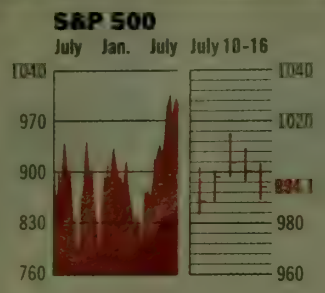
nly the stout-hearted might want to touch shares of 24/7 Real Media (TFSM), whose stock collapsed from a high of 64 in January, 1999, to 9¢ on Sept. 21, 2001. It has since bounced to 1.81 on July 16, 2003—thanks to the runup in tech and Internet stocks. The company is still an effective marketing outfit that helps advertisers target consumers online, says Jonathan Cohen, head of JHC Capital Management, which owns shares. And it's starting to benefit from the online advertising boom. Its Web Alliance network aggregates and sells ads of hundreds of smaller sites unable to pay their own sales forces. Cohen notes that while about 80% to 90% of Web traffic is handled by major portals such as AOL, Yahoo! (page 72), and Microsoft, scores of other sites with strong daily traffic are too small to hire sales reps. So they outsource the function to 24/7 Real Media. Over time, he sees the share of Web traffic among top portals falling in favor of niche sites. Cohen figures 24/7 will turn a profit in 2003 on revenues of $45 million to $50 million. Last year, it lost 23¢ a share on $42.5 million.

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:40 p.m. EST on CNNfn's *The Money Gang*.

se noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

BusinessWeek Investor FIGURES OF THE WEEK

STOCKS



COMMENTARY

The stock market stalled despite good earnings reports from such blue chips as J.P. Morgan Chase, Merrill Lynch, and Intel. The cause? A sell-off in bonds, where 10-year Treasury yields rose 24 basis points in the face of Fed Chairman Greenspan's determination to reflate the economy. Still, what may be bad for the coupon clippers could be good for equity buyers.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	JULY 16	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	994.1	–0.8	13.0	10.3
Dow Jones Industrials	9094.6	–0.7	9.0	7.3
NASDAQ Composite	1748.0	0.0	30.9	27.1
S&P MidCap 400	496.4	–0.7	15.5	12.6
S&P SmallCap 600	231.0	–1.1	17.5	14.1
Wilshire 5000	9579.3	–0.8	14.8	12.1
SECTORS				
BusinessWeek 50*	587.2	–0.3	8.2	8.4
BW Info Tech 100**	320.3	–0.9	12.2	9.9
S&P/BARRA Growth	507.0	–0.4	13.0	12.2
S&P/BARRA Value	483.8	–1.2	13.0	8.4
S&P Energy	188.2	–3.1	2.8	0.3
S&P Financials	346.1	0.5	16.6	12.3
S&P REIT	103.3	0.0	13.7	9.1
S&P Transportation	179.0	–0.9	5.3	–0.7
S&P Utilities	105.2	–4.6	7.6	–0.3
GSTI Internet	130.8	–3.9	75.1	87.2
PSE Technology	595.1	–0.8	29.8	25.2

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JULY 16	WEEK	YE
S&P Euro Plus (U.S. Dollar)	944.8	0.0	
London (FT-SE 100)	4077.1	0.6	
Paris (CAC 40)	3150.7	0.3	
Frankfurt (DAX)	3387.6	2.0	
Tokyo (NIKKEI 225)	9736.0	–2.6	
Hong Kong (Hang Seng)	10,207.2	1.8	
Toronto (S&P/TSX Composite)	7082.0	–0.5	
Mexico City (IPC)	7023.9	–2.1	

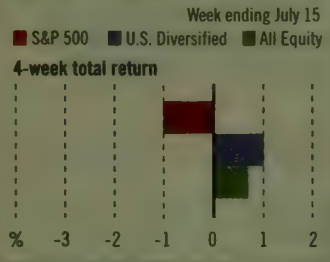
FUNDAMENTALS	JULY 15	WK. AG
S&P 500 Dividend Yield	1.63%	1.61
S&P 500 P/E Ratio (Trailing 12 mos.)	32.5	32.7
S&P 500 P/E Ratio (Next 12 mos.)*	17.3	17.5
First Call Earnings Surprise*	4.27%	6.5

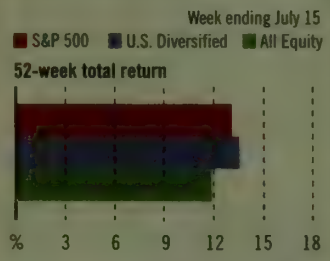
TECHNICAL INDICATORS	JULY 15	WK. AG
S&P 500 200-day average	899.7	895.7
Stocks above 200-day average	85.0%	87.0
Options: Put/call ratio	0.68	0.73
Insiders: Vickers NYSE Sell/buy ratio	4.08	4.20

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Semiconductor Equip.	16.1	Internet Software	131.5
Wireless Services	14.0	Biotechnology	100.4
Semiconductors	11.1	Office Electronics	72.4
Internet Retail	11.0	Wireless Services	59.2
Electric Mfg. Svcs.	10.9	Homebuilding	41.4

WORST-PERFORMING GROUPS	LAST MONTH %	
Photographic Products	–15.7	Tires & Rubber
Tires & Rubber	–13.6	Health-Care Facilities
Homebuilding	–13.5	Food Chains
Oil & Gas Drilling	–11.2	Steel
Conglomerates	–10.1	Automobiles

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Japan	9.5	Health	28.8
Pacific/Asia ex-Japan	6.8	Communications	24.1
Technology	6.5	Technology	22.5
Diversified Pacific/Asia	6.3	Small-cap Growth	20.1
LAGGARDS		**LAGGARDS**	
Precious Metals	–7.2	Japan	–7.0
Europe	–5.6	Diversified Pacific/Asia	–2.3
Natural Resources	–4.9	Foreign	1.9
Utilities	–3.9	Pacific/Asia ex-Japan	2.0

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Apex Mid Cap Growth	20.1	Jacob Internet	121.0
PFds. Smicdr. Usctr. Inv.	17.5	PFds. Biotch. UltS. Inv.	107.8
Matthews Asian Tech.	15.9	Fidelity Adv. Lvgd. Co. A	92.1
Pacific Advs. Sm. Cap A	15.7	Amerindo Technology D	88.8
LAGGARDS		**LAGGARDS**	
Driehaus Europ. Oppy.	–60.0	Rydex Dynam. Vent. 100	–59.6
PFds. Pr. Mtls. U. Inv.	–13.8	PFds. UltSh. OTC Inv.	–59.6
PFds. UltSh. OTC Inv.	–9.5	Frontier Equity	–58.2
Rydex Dynam. Vent. 100	–9.4	Driehaus Europ. Oppy.	–49.6

INTEREST RATES

KEY RATES	JULY 18	WEEK AGO
MONEY MARKET FUNDS	0.67%	0.68%
90-DAY TREASURY BILLS	0.89	0.86
2-YEAR TREASURY NOTES	1.43	1.33
10-YEAR TREASURY NOTES	3.92	3.68
30-YEAR TREASURY BONDS	4.90	4.70
30-YEAR FIXED MORTGAGE†	5.06	5.55

†Bank

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND
GENERAL OBLIGATIONS	3.56%
TAXABLE EQUIVALENT	5.09
INSURED REVENUE BONDS	3.65
TAXABLE EQUIVALENT	5.21

THE WEEK AHEAD

LEADING INDICATORS *Monday, July 21, 10 a.m. EDT* ▶ The Conference Board's index of leading indicators for June is forecast to have increased by 0.2%. That's according to the median forecast of economists surveyed by MMS International. In May, the index jumped 1%.

FEDERAL BUDGET *Monday, July 21, 2 p.m. EDT* ▶ The federal government will probably report a June surplus of $20.5 billion, after a $90.5 billion deficit in May. The Bush Administration revised its fiscal 2003 forecast budget shortfall to $455 billion, from $304 billion. The deficit for fiscal 2004 was upped to $475 billion.

DURABLE GOODS ORDERS *Friday, July 25, 8:30 a.m. EDT* ▶ New orders for durable goods most likely increased by 0.7% in June, following a 0.4% decline in May.

NEW RESIDENTIAL SALES *Friday, July 25, 10 a.m. EDT* ▶ New single-family home sales in June probably eased to 1.07 million, from a record 1.16 million during May.

EXISTING HOME SALES *Friday, July 25, 10 a.m. EDT* ▶ Existing home sales in June are expected to have fallen slightly, to nual rate of 5.9 million. In May, sa picked up to a pace of 5.92 millio

The BusinessWeek production index i to 197.5 for the week ended July 5, up 3. a year ago. Before calculation of the fo moving average, the index held steady a

BusinessWeek online

For the BW50, more investment data, a components of the production index **www.businessweek.com/magazine/e**

Retirement Planning 2003: Investment and Financial Insights

LPs Provide High Income, th and Tax Deferred Income

iliar with publicly trad- Limited Partnerships Neither are many other You may be missing ng.

re similar to stocks raded on the NYSE, d NASDAQ. Investors nits rather than shares mited partners rather holders. The units rep- nership and in earnings. r, MLPs have advantages. provided tax o MLP in- n order to pital to the nd natural industries. not pay tax t distribute idend) most cash flow s. Significant ible depreci- ns most of bution is tax until an in- s or receives income initial investment. reporting purposes, receive a form K-1 a form 1099.)

nique structure and ons, make MLPs less to institutional in- e pension funds and nds. This has resulted al research coverage erage firms and, as many individuals are unaware of the oppor- s neglect has created t opportunities and s for those who take investigate.

p's index of 20 energy uch as pipelines, nd coal companies l market value of over n) has produced a annual return over g the 10 years ended May 31, 2003. Not only do these returns compare favorably to the S&P 500, but they were produced with significantly less volatility due partially to their high current income. MLPs also offer low historical correlation to both the stock and bond markets.

The current yield on the MLP index was 7.4% as of May 31, 2003, which compares favorably to other capital market alternatives, particularly considering the tax deferral. Furthermore, distributions have grown over 5% annually.

MLPs have limited exposure to commodity risks inherent in oil and gas prices because they are predominately in the transportation, processing and storage side of the energy industry. A carefully selected, diversified portfolio of MLPs can further control risk while providing high income and reasonable growth potential. Work with your investment advisor to select an MLP portfolio manager who can build a diversified portfolio of MLPs with reliable growth prospects, solid financial positions, reasonable acquisition policies and attractive relative valuation.

Atlantic Asset Management LLC.

Atlantic and its affiliates invest over $8 Billion for clients in an array of separately managed bond, high yield, enhanced stock, hedge fund and MLP portfolios. Tortoise Capital Advisors, LLC is the firm's team focusing on separately managed portfolios of MLPs. Each Atlantic team has the commitment and agility typically found in small, independent firms, but together they form a large institution with associated efficiencies, resources and stability. Each team has an established track record using disciplined investment processes. Visit www.atlanticasset.com or www.tortoiseadvisors.com for more details.

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Investment Diversification Through Self-Direction

Many people are unaware of all the investment choices available within their retirement plans. Most invest in traditional assets such as stocks, bonds and mutual funds. Did you know you can invest in real estate, mortgages, leases, and other asset backed investments?

With a truly self directed plan you can invest in assets you know, understand, and effectively control. Whether you have a 401(k), IRA, Roth IRA, SIMPLE, or SEP, this option for diversification, continual growth and appreciation is important for you.

Now, more then ever, we need to take control of our financial future. The govern ment has increased contribution limits to allow you to take full advantage of saving for the future. Since 1975 self-directed plans have been available. This allows you to compound your assets quickly with investments you select. Remember, tax deferral increases yields by as much as 40% as a result of the lack of immediate taxation.

Three things you need to know when you self-direct your retirement plan:

- Which retirement plans are best. You can have more than one.
- What kind of investments you want to make within the plan.
- There are IRS rules prohibiting self-dealing. Understanding them makes self-direction easier for you.

Frequently asked questions:

1. What if I have a 401(k)? You can roll your old 401(k)s into a traditional IRA or to another 401(k) plan, such as an Individual (k) with no tax consequence.
2. Which self-directed plans are available to small businesses?

Business owners without common law employees may qualify for the Individual(k) allowing up to 55% of AGI income contributions to your plan. Businesses with employees, other than spouses and partners, qualify for the Flexible 401(k). SEP-IRAs and SIMPLE-IRAs are also self directable but have lesser contribution limits. For specifics on how to qualify for the Individual(k), search the Internet for Individual(k).

The dollars you earn today can be put away and compounded to help you accomplish those financial dreams we all wish for. Don't wait! Now is the time to open a self-directed plan, and start investing in your future.

Entrust
Administration, Inc.

Change...in employment, in direction, in investment. Controlling your financial future today may impact your lifestyle tomorrow. Entrust specializes in all self-directed retirement plans that offer complete control to help manage your financial future. Increase your retirement dollars with any investments you know and understand!

Need to learn more? Attend one of Entrust's continuing education workshops, listen to the company's radio show, live, on the Internet and visit their site at www.iraplus.com for a local office near you.

Insight provided by Lisa Moren

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www.iraplus.com

Retirement Planning 2003: Investment and Financial Insights

Earn Competitive Returns Investing in Green Companies

With the environment now under assault from unscrupulous corporations and neglectful governments, many investors would like to know that they can save for retirement and other important goals without hurting the environment at the same time.

Some are concerned that a lack of information about the social and environmental policies of companies and the potentially lower returns of their stocks could make it difficult to achieve their investment goals. Research shows that both of these two issues are being overcome.

Recently, "socially and environmentally responsible mutual funds [have] continued their strong performance," according to data from the nonprofit *Social Investment Forum*. As of March 31, 2003, 72 percent of the socially and environmentally screened mutual funds with $100 million or more in assets received top marks for performance from either or both Morningstar and Lipper.

Timothy Smith, who is the President of the *Social Investment Forum* commented: "Performance continues to be an important and compelling part of the story of the success of socially and environmentally responsible mutual funds."

Currently there is no single comprehensive source of information on companies' environmental records, but there is a wealth of information available. Two great places to start your research are the Social Investment Forum (www.socialinvest.org) and the *GreenMoney Journal* (www.greenmoney.com).

Using these resources can help individual investors identify and purchase environmentally or socially responsible stocks or mutual funds for their IRAs, annuities or other long-term investment accounts.

Retirement savers should also urge their employers to work with their 401(k) or 403(b) retirement plan provider to offer at least one environmentally or socially responsible investment option in their retirement plan. This will allow employees to make ongoing investments to support socially and environmentally friendly companies.

Recently, the nation's largest and most influential grassroots environmental organization recognized the need for more environmentally conscious investment vehicles and established a family of no-load mutual funds (see inset) that allow investors to save for their future while helping to protect the planet.

Although the Funds are no-load, other annual fees and expenses do apply as described in the prospectus. Past performance is no guarantee of future results. The Sierra Club Funds may choose not to purchase, sell or retain otherwise profitable investments in companies which have been determined as being in conflict with the established social and environmental guidelines of the Sierra Club. For more information about the Sierra Club Funds, including fees and expenses for an initial or continued investment, please order a prospectus by calling (866) 897-5982. Investing in the Funds involves certain risks which are fully discussed in the Funds' prospectus. Please read the prospectus carefully before you invest or send money. Distributed by PFPC Distributors, Inc., 760 Moore Road, King of Prussia, PA 19406

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Mutual Funds

To be eligible for investment by the no-load Sierra Club Mutual Funds, a company must pass more than 20 environmental and social guidelines that have been created by the Sierra Club – America's most influential environmental organization. Call or visit Sierra Club's website today to find out how easy it is to begin investing for retirement in socially and environmentally friendly companies.

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"Charitable Employmer the Other Retirement B

Did you know that you could put additional tax deductible dollars into your own foundation, let it grow tax free, and then be employed with those funds at a reasonable compensation level to do bona fide charitable work. Yes indeed, you can!

Each time we make a conscious effort to legally employ charitable strategies to defer or eliminate taxation on our income or appreciated assets we have redirected some social capital. In many cases by redirecting this capital, people are able to achieve their family goals and incorporate charitable good works in their plan. By not exploring these alternatives, families have chosen an unspoken charity, Uncle Sam. Usually, they don't even know it. We can change involuntary philanthropy "taxes", into voluntary philanthropy. By redirecting social capital we all can help put dollars back into our communities.

Everyone is always looking for ways to save more dollars on a tax-preferred basis. And, those of you with competent advisors should have taken advantage of the tax law changes concerning qualified pension design. If so, you are deferring as much income allowed under current tax law. When you have maximized these traditional boxes for retirement you need to thin other retirement box. Employment.

Charitable emplo achieved by establishir advised fund with a c allows this activity. C you and others will ability to transfer tax funds to your found count. The monies gro and then can be uti charitable employment. the proper philanthropi is key. Only a few org and advisors exist that c this task, "refer to firm

By putting monies i foundation, you will taxes and start to es social capital account to accomplish your future good works. Wow, pa teerism. Just think of all ects that could be funde Charitable Employment

"By not exploring these alternatives, families have chosen an unspoken charity, Uncle Sam."

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This information is of a general does not constitute the provision ment, legal, tax or accounting ad person, or a recommendation to b any security. Opinions expressed subject to change without notice. seek the advice of an investment to tailor a financial plan to your needs.

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Strategic Wealth Advisors provides finan ning and investment advisory services t individuals, charities, corporations and tions. The company specializes in asset ment, estate planning, charitable est ning, retirement planning and busines sion planning. Strategic Wealth Adviso the difficult become simple. Let them redirect some social capital.

Darin L. Martinelli, CPhD, CCEP, CFP® is th Founder of Strategic Wealth Advisors, LLC tinelli and his firm are committed to help achieve their financial, estate and charitab

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Retirement Planning 2003: Investment and Financial Insights

What Is Morally Responsible Investing?

Responsible Invest- is often considered a f the more popular Responsible Investing RI usually has a enda relating to the ent, labor relations, ssues, human rights, bacco, nuclear power, , gambling mal rights hers.

Responsible g on the nd, typically ore narrow it relates to

Responsible Funds often t companies ort abortion, aphy, anti- festyles and tices that are to religious

nvestors are that their nds invest in compa- support abortion, phy, anti-family en- nt and non-marital Most mutual fund

lly Responsible utual Funds ide investors he opportunity st in portfolios mpanies that t violate their us principles."

base their investment solely on financial rporations, often not r caring what types ral activities these portfolios of companies are supporting. Morally Responsible Mutual Funds base investment decisions on financial data and religious criteria.

Some MRI Funds take an activist approach and try to change corporate behavior via letter campaigns or shareholder resolutions. Boards of directors however, have been reluctant to amend corporate policies under pressure from dissident shareholders.

Other Morally Responsible Mutual Funds take a passive approach, and simply blacklist companies whose policies conflict with their Fund's charter. For instance, corporations which contribute to Planned Parenthood, the largest provider of abortions in the country, are screened out of the portfolios of Catholic Mutual Funds.

It is important that investors be given the opportunity to invest in accordance with their religious beliefs. Morally Responsible Mutual Funds allow investors to invest in portfolios of companies that do not violate their religious principles.

AVE MARIA MUTUAL FUNDS

Three separate mutual funds with separate investment objectives. All managed by seasoned investment professionals who select securities based on sound investment fundamentals and Catholic Pro-Life values. Investors with long-term goals do not have to sacrifice their religious beliefs to pursue their financial objectives. The Ave Maria Catholic Values Fund (AVEMX), the Ave Maria Growth Fund (AVEGX), and the Ave Maria Bond Fund (AVEFX) are distributed by Schwartz Fund Distributors, Inc.

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www.avemariafund.com

Preferred Securities Go Mainstream

With interest rates near five-decade lows, investors are seeking ways to boost portfolio yields while keeping risk at reasonable levels. Preferred securities offer higher yields than traditional corporate bonds, but carry lower credit risk than junk bonds. Also, preferreds provide investors with valuable portfolio diversification.

The combination of high yield, credit quality and, now, lower tax rates on dividends has brought preferred securities into the mainstream for individual investors. Even before Congress reduced tax rates on dividend income for individuals, investors had embraced the preferred securities market. From June 2002 through May 2003, investors purchased more than $6.6bn in new closed-end funds investing in preferred stocks and related securities. These closed-end funds provide professional management for this complex market, where a thorough understanding of both credits and structure is critical to success.

"Importantly, for investors, preferreds pay higher yields than senior debt to compensate for their subordination, thus offering potentially higher returns without reaching down to junk credits."

Preferred securities can be divided into two basic types: traditional preferreds, which pay dividends, and taxable or "hybrid" preferreds, which pay interest. While traditional preferreds yield less than hybrids, their tax preference may result in higher after-tax yields. Both types generally rank junior to all other debt of the issuer, but senior to common equity. The terms and structure of these securities can vary significantly from issue to issue, so investors must pay careful attention to each holding in their portfolios.

Companies in the banking, financial services and utility industries make up the largest group of preferred issuers. Importantly, for investors, preferreds pay higher yields than senior debt to compensate for their subordination, thus offering potentially higher returns without reaching down to junk credits. As of May 2003, there were $50bn in traditional preferreds and $189bn in hybrid preferreds outstanding, mostly issued by companies whose senior debt is rated investment grade.

Preferred securities offer retirement investors two tax-efficient ways to achieve their goals. Traditional preferreds offer tax advantaged income for those in higher tax brackets who either are already retired and seeking current income or are maxed-out on their 401K or IRA contributions and want to accumulate income with relatively low drag from taxes. Taxable preferred securities are suitable for IRAs and other tax-deferred accounts or for those who simply want high current income.

Closed-end funds provide individual investors with diversification and professional management and make the benefits of the preferred market more accessible than ever before. A growing universe of preferred funds offers investors a variety of investment approaches. All use leverage to magnify the benefits (and risks!) of investing in preferreds. A few funds, in addition, offer hedging strategies intended to reduce the risk of rising interest rates.

Retirement Planning 2003: Investment and Financial Insights

Making Sure Your Money Lasts As Long As You Do

Retirees or pre-retirees have no shortage of potential worries: fluctuating markets, global tensions, inflation and taxes, even corporate chicanery.

But perhaps the overarching fear is that for any of those reasons they will run out of money before they run out of time.

This is a real threat. Many who think they have enough to live on for the rest of their lives discover that inflation and taxes—or a bear market—eat away at their financial cushion until they either must cut back drastically on their lifestyle or return to work.

With some planning, though, even a novice investor can make use of a basic retirement philosophy—known as Buckets of Money®—that seeks to provide lifelong income but still offers growth potential.

The key is dividing your retirement savings into three piles, or "buckets," and knowing the best investments for each bucket.

For example, you need safe, reliable monthly income to live on. That's a short-term liability, so in Bucket No. 1 you put short-term assets with little or no risk. Possibilities include immediate annuities, money-market accounts, laddered CDs or perhaps short-term bonds.

Then down the road, you'll need more income because of inflation. That's a mid-term liability, calling for higher-yielding, mid-term assets. Those are tough to find in today's environment of declining interest rates, but a qualified financial advisor may help you choose among, say, corporate high-yield bonds or even real estate investment trusts.

And, of course, you also want your money to grow over the long run and give you a further hedge against inflation. That's a long-term liability to be funded with long-term assets, such as stocks and real estate in Bucket No. 3.

Bucket No. 1 and then Bucket No. 2 can be spent down for income while the riskier and potentially higher yielding assets of Bucket No. 3 are left untouched for a number of years. Thus, the longer time horizon should help smooth the ups and downs of the market or any other short-term factor.

This smart, yet conservative way to manage your nest egg may be good for investors who seek retirement income and want to preserve principal, but who also realize that the purchasing power of a 100% low-risk portfolio may be reduced by inflation over time.

In the wake of a plan, even the Buckets of Money® strategy, you may be more likely to retire with confidence despite the inevitable bear markets.

[1] *There is no guarantee that the Buckets of Money Strategy will meet its stated objectives.*

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The Raymond J. Lucia Companies, Inc. (RJL) based in San Diego California is an SEC Registered Investment Advisory Firm that provides comprehensive financial planning services to individuals and corporations both locally and nationally. RJL utilizes some of the foremost management consultants, attorneys and CPA's to assist in planning. The advisors of the Raymond J. Lucia Companies are also registered representatives of **Securities America, Inc.** a registered broker/dealer with over 1,400 financial professionals nationwide.

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Six-Figure Deductions?

If your qualified plan isn't giving you as large a write-off as your business needs, consider the 412(i) solution.

Saving for retirement isn't easy. In fact, many self-employed individuals put saving for retirement off until their business is successful and the money is "rolling in".

Unfortunately, that creates a new problem – under federal tax law, individuals needing to play "catch-up" with their retirement savings are limited in how much they can defer into their 401(k) or other retirement plans. But what if there were another way? What if they could defer large sums of money – every year – even if those dollars amounted to six figures a year? What's more, what if those deferrals were completely tax-deductible to the business?

Introducing the 412(i) solution – A defined benefit pension plan that allows for substantial deferrals – and deductions – each and every year. 412(i) plans offer:

- Annual tax deductions of $200,000 or more per year, providing you qualify
- Tax-deductible contributions
- Retirement benefits which are completely guaranteed*
- Tax-deferred growth
- Protection from lawsuits, creditors and other risks
- No need for an enrolled actuary's certification
- Low plan administration costs
- Plus, they're easy to understand!

At retirement, 412(i) plans are completely portable, allowing owners to transfer their annuity accumulation to any IRA rollover program they choose. In a when funded with life in 412(i) plans provide benefits that can help p spouse or children in the premature death.

Could a 412(i) plan for you? It might be if:

- You're looking for the l tax deduction possible
- You want to favor older Compensated employ
- You can commit to an series of payments
- You have six or fewer employees where the Highly Compensated employees are much y than the Highly Comp employees you want t
- Your business is highly profitable
- Your key employees ar 5-10 years of retireme

If you've reached y funding limits under yo ing qualified plan, or if your business required yo off saving for retirement, it to yourself to find c about the 412(i) solution

**Guarantees are dependent upon paying ability of the issuing compa*

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SANDY WEILL'S LEGACY

Citigroup Chairman Sanford I. "Sandy" Weill chose an opportune moment to turn over the job of chief executive officer to his top adviser, Charles O. "Chuck" Prince III (page 30). Weill's July 16 announcement came after more proof that he has continued to do what he has always done best: deliver strong financial results. On July 14, the world's largest financial company announced a 5% gain in second-quarter earnings as net revenue hit a record $19.4 billion. Citigroup stock is up 40% since its February low. Said Prince Alwaleed bin Talal, the company's largest shareholder: "I will hold their shares forever."

Again and again in his long career, the 70-year-old Weill has shown an uncanny ability to buy undervalued companies, strip away overhead, and mesh them with his growing financial machine. His conquests range from Primerica to Travelers, Citicorp, and Golden West Financial. Since 1986, the total return to shareholders of Citigroup and its predecessor companies run by Weill has been 22% a year, double that of the Standard & Poor's 500-stock index.

But if Weill is an investor hero, he's a flawed one. On his watch, Citigroup has run afoul of prosecutors and regulators. His star telecom analyst, Jack Grubman, quit last year amid charges that he pushed stocks he didn't believe in simply to help Citigroup land investment-banking business. Weill himself urged Grubman to "take another look" at AT&T shortly before a big underwriting decision. Weill was never c with any wrongdoing. He did, however, sit on AT&T's while its chairman served on Citigroup's. Though leg interlocking directorates are not exactly good corpora ernance. This year, Citigroup agreed in April to pay $4 lion to settle charges brought by New York Attorne eral Eliot Spitzer—the most money paid by any Wall firm. One highly unusual provision of the settleme bids Weill to speak with his own securities analysts ab companies they cover.

Reformers argue that Citigroup's transgressions isolated slipups—instead, they're the inevitable outco corporate structure in which synergy turns into conflic terest. There's an inherent conflict of interest betwee ing money to a company and selling its stock to in Likewise, there's a conflict between advising peopl stocks to buy and earning fees as an underwriter of st theory, of course, these conflicts can be managed. Citigroup, they sometimes haven't been.

Weill is likely to remain chairman of Citigroup until t of 2005. He has already made a good start at reform by ing in the respected Sallie L. Krawcheck to run the br business. He would be wise to continue using his statur sure that his legacy will be an institution that is not nancially successful, but ethically exemplary as well.

WELCOME BACK SHAREHOLDER CLOUT

The bear market and corporate scandals of the past several years weren't all bad. If nothing else, shareholders woke up to the fact that the companies they own had slipped out of their control. Galvanized by disastrous returns, they're finally exerting power. And chief executives who once ran companies like personal fiefdoms are behaving more like the employees they are. The comeback of shareholder power is evident in everything from increased dividend payouts, to cutbacks in option grants to top bosses, to new government rules that increase shareholder clout. It's all long overdue.

Start with dividends. Not so long ago, CEOs whose companies paid dividends were perceived as timid and unimaginative. Now, even longtime holdout Microsoft Corp. has started paying one, however small. And other companies are looking to initiate or raise payouts. Sure, the recent cut in taxes on dividends is one reason for the change. But an equally important factor is the realization in boardrooms across America that CEOs don't always have a better use for shareholders' money—i.e., profits—than the shareholders themselves do.

The nascent trend toward rewarding employees with restricted stock instead of stock options is another victory for shareholders (page 36). Options have their place, especially in startup companies. But they are funny money whose value fluctuates dramatically in response to changes in th price. The option mania of the 1990s, combined with t market, transferred more wealth to top executives than holders ever intended. Whenever the next bull market it's highly likely that the same kind of unintended transfer will recur at companies that issue lots of opti contrast, the value of restricted shares is far more stabl understandable. By switching to awards of restricted Microsoft, Exxon Mobil, and other companies are ensuri their top executives and other employees will get a fai of future stock appreciation, but not the lion's share.

As shareholders attempt to assert control, they're fo to have an ally in Washington. Under Chairman Will Donaldson, the Securities & Exchange Commission ha decidedly pro-shareholder agenda. In late June, the S proved a requirement that shareholders vote on equit pensation plans, including options. Now, at Donaldson's the SEC's staff is drafting rules that would make it ea outside shareholders to nominate directors in oppositio board's own slate. The SEC's reforms, coupled with a ne assertiveness by shareholders themselves, are right imbalance of power between corporate insiders and ou that has existed for too long.

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VERIZON'S GUTSY BET

How CEO Ivan Seidenberg is trying to remake his company—and the telecom industry

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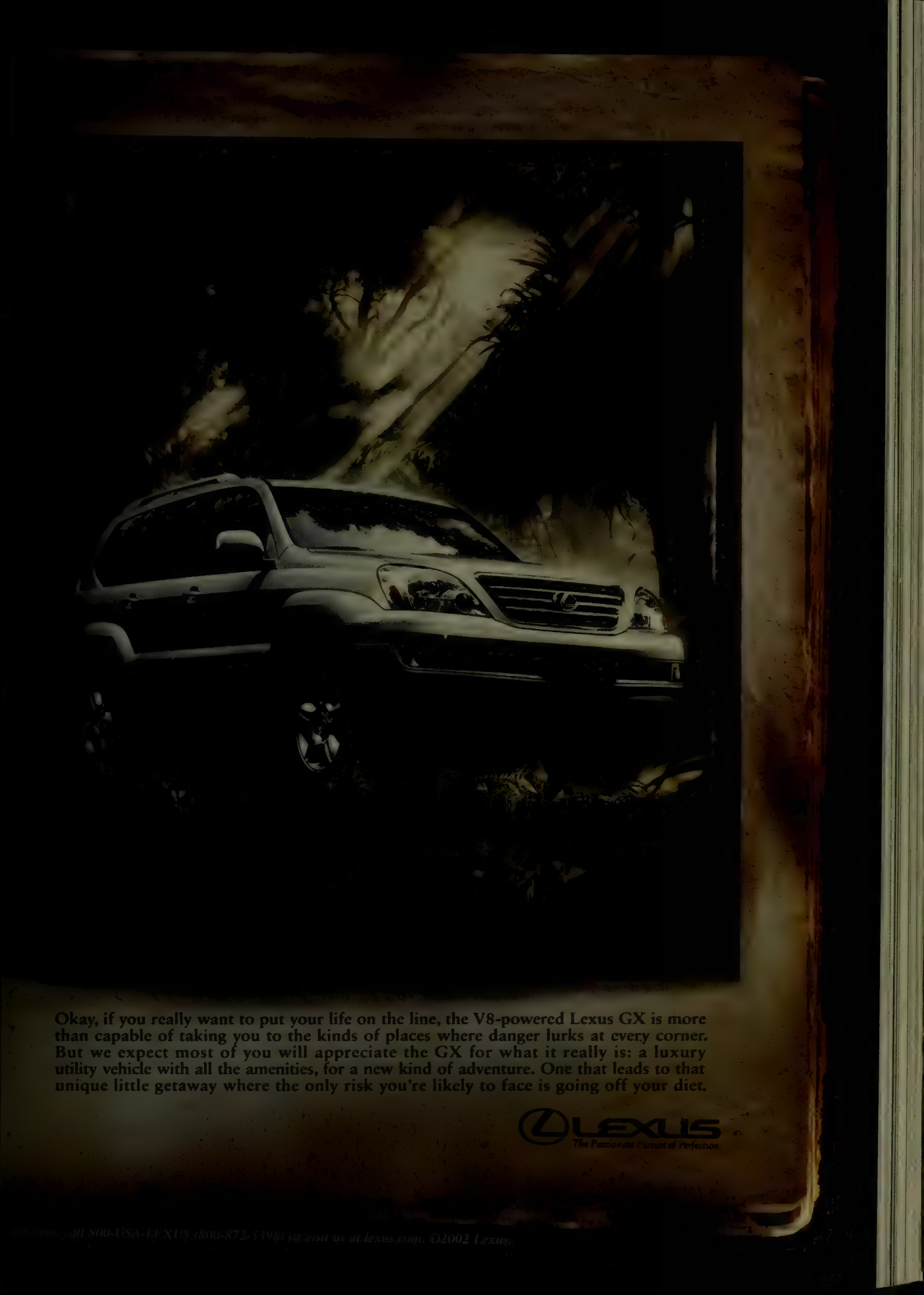
There I was face to face
with a Malaysian tiger

prawn in garlic and butter



Okay, if you really want to put your life on the line, the V8-powered Lexus GX is more than capable of taking you to the kinds of places where danger lurks at every corner. But we expect most of you will appreciate the GX for what it really is: a luxury utility vehicle with all the amenities, for a new kind of adventure. One that leads to that unique little getaway where the only risk you're likely to face is going off your diet.

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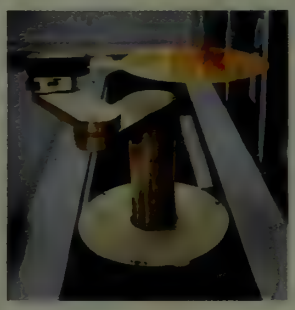
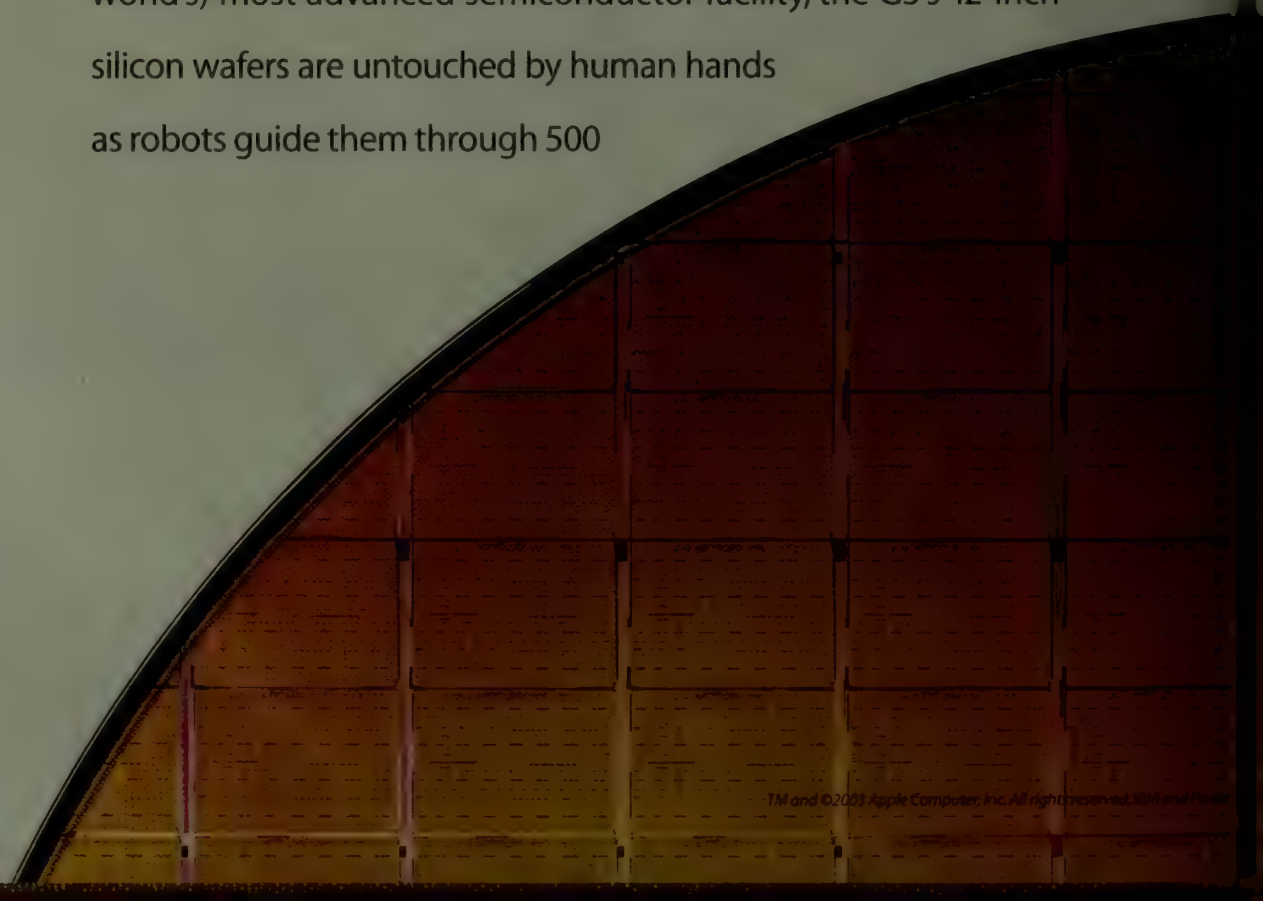
The dawn of a new PC

For the last decade, every processor chip in every personal computer in the world has been based on 32-bit architecture. It was the best technology we had. Until today. Introducing the revolutionary PowerPC G5 processor, the world's first 64-bit processor for personal computers.



The world's most advanced personal computer chips are manufactured in the world's most advanced semiconductor factory.

Before now, a chip this formidable could only be found in the world's fastest servers and supercomputers. Which is precisely where the G5 chip came from. Developed by IBM and Apple; the G5's DNA is from the core of IBM's highest performance 64-bit POWER4 processor. But just as impressive as the G5's pedigree is how it's manufactured. In IBM's (and the world's) most advanced semiconductor facility, the G5's 12-inch silicon wafers are untouched by human hands as robots guide them through 500



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64-bit processor.

processing steps, creating 58 million transistors and connecting them with over 1000' of copper wire that's less than 1/800th the width of a human hair.

The new PowerPC G5 has a 1-gigahertz frontside bus* that moves data in and out of the processor almost twice as fast as the competition, removing a key bottleneck that limits performance. And it can support more than 200 in-flight instructions at a time – 71% more than the 32-bit Pentium 4. Perhaps most importantly, the G5's 64-bit architecture can address dramatically more memory – over 4 billion times more than 32-bit chips – so that systems built around the G5 can shatter the 4-gigabyte memory ceiling that limits every other PC on earth. The 64-bit PowerPC G5. It's not just a new chip. It's the next chapter in personal computing.

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BOLD VERIZON

BROADBAND BET

It will cost Verizon at least $20 billion to wire all its customers with fiber-optic cable. But CEO Seidenberg figures he has no choice but to go on the attack to counter the rise of cable

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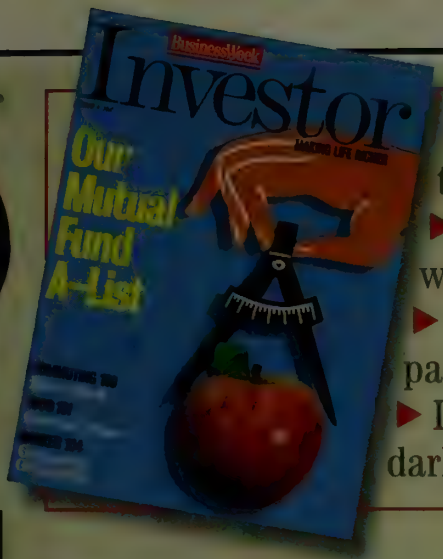

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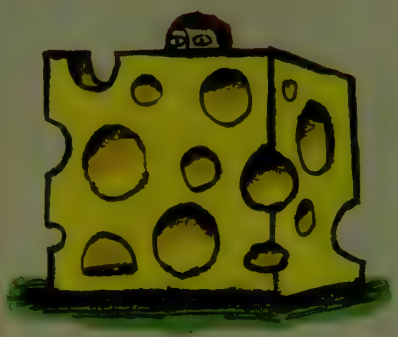

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EST GLOBAL BRANDS
ns of people around the world rously protest U.S. policies. doesn't stop them from being siastic consumers of Dell ters, Starbucks coffee, Levi's Coke, and Big Macs. That's n *BusinessWeek*'s ranking of p 100 global brands, ican companies predominate, 2 places, including 8 of the). But plenty of foreign brands great showings, too. Here's he brands stack up

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lating the power in a name

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CLOUD THE ISSUE

The issue of global warming has given rise to heated debate. Is the burning of fossil fuels and increased concentration of carbon dioxide in the air a serious threat or just a lot of hot air?

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OR CLEAR THE AIR?

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Starting to Thaw?

It sure looks as if America's capital markets are beginning to come out of the deep freeze, and both small-fry and corporate giants are buying. It's one hopeful sign of an economic recovery

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Up Front

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EX-CEO: *Pending charges*

near Princeton, N.J. Kozlowski's lavish offices in Boca Raton, Fla., will be carved into cubicles for Tyco's Fire & Security unit. And the former headquarters in Exeter, N.H., has been sold to Bentley Pharmaceuticals.

Tyco's fleet of 13 airplanes and helicopters is down to two planes and one chopper. Two of the multimillion-dollar corporate apartments have been sold, and a third is on the block. Pending legal actions against Kozlowski—whose trial on criminal corruption charges starts Sept. 29—have delayed Tyco from selling his much-buzzed-about Fifth Avenue pad.

Breen also has replaced the corporate staff—some 70 people. As a result, he says, "it's not like everyone is around the water cooler talking" about Kozlowski's trial. It's almost as if the institutional memory of the former CEO has been wiped clean.

William Symonds

PERKS PARADE

SELLING OFF KOZLOWSKI'S WORLD

ONE YEAR AFTER HE WAS hired to save Tyco International, CEO Edward Breen is close to wiping away the most obvious emblems of Dennis Kozlowski's opulent reign. Later this summer, Breen will move Tyco's U.S. headquarters from its swank Manhattan setting to a building

CAR TALK

PORSCHES? THAT'S AISLE FOUR

BRITISH NETIZENS KNOW where to buy new cars: Virgin Cars, the brainchild of billionaire Richard Branson and auto industry consultant Ian Lancaster. Despite initial resistance from carmakers, Virgin has sold 12,000 vehicles—from Fiats to Audis—since the Web site began in 2000.

That's just the start. In May, Virgin also launched the world's first auto department store that sells competing models side by side. It offers discounts of up to 30% and a no-haggle guarantee. Buyers snapped up 150 cars in the first six weeks, and sales could rise 50%, to $136 million, this year, says Lancaster. He plans 12 more stores over seven years.

As for dealers, the European Union has only lately let them sell rival brands. "We'll see a revolution in the distribution market for cars," says analyst Thomas Aney at Dresdner, Kleinwort Wasserstein in Frankfurt. No doubt. Browsing at a car supermarket certainly beats haggling at the dealer.

Gail Edmondson

VROOM: *Audi ragtop*

TALK SHOW "Brands do not conquer markets. They d have armies. They are citizens of the world."

—Marc Gobé, president of consultant Desgrippes Gobé, sayin U.S. brands can thrive despite antipathy to U.S. foreign polic

WRETCHED EXCESS

NOT EVERYONE IS DITCHING OPTIONS

DESPITE MICROSOFT'S DECISION to use stock rather than options to inspire employees, the stock-option culture is alive and well—and living in Redwood Shores, Calif. On July 11, Oracle CEO Larry Ellison received a staggering 900,000 options, part of 5.9 million options granted to seven top execs. That's in marked contrast to Microsoft, where neither Bill Gates nor Steve Ballmer has ever received options.

Oracle defends the grant, saying it's Ellison's first pay since 1999, when he suspended his salary and bonus in exchange for 40 million options, many of which are now under water. Says Ellison: "900,000 sounds like a lot, but it's a tiny fraction of the company."

But governance experts say Ellison's latest grant is a classic misuse of options. They're supposed to be an incentive, not a subs salary or a reward.

Ellison already own fourth of Oracle—with and options worth near billion. If that doesn't p a meaningful incenti him to rev up the so maker a further 900,0 tions certainly won't. "

ELLISON: *Big Oracle p*

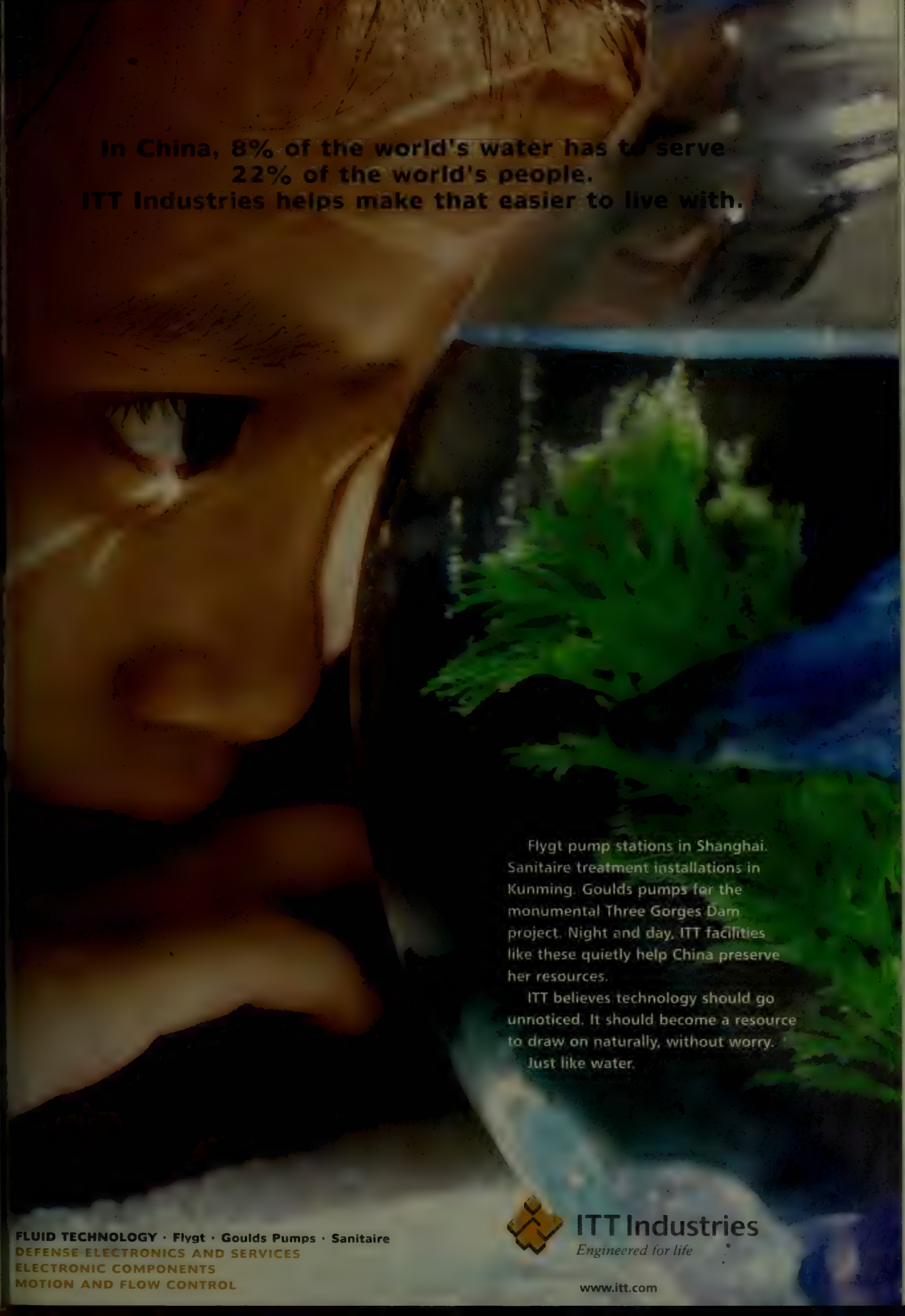
gles the mind," says P McGurn, senior vice-pre at proxy adviser Instit Shareholder Services. in the world are you him incentive compen for?" *Louis L*

THE LIST MEDIA MOGUL AFTERLIVES

Attempts by the Federal Communica Commission to ease rules on media ownership could spark fresh deals, returning ex-kingpins to the spotligh Some former top execs are looking leverage old relationships for a bigg industry role. Here's who's doing wh

MOGUL/OLD JOB	NEW GIG
JEAN-MARIE MESSIER CEO, VIVENDI UNIVERSAL	Launching a consulting and investment firm in Manhattan
ROBERT PITTMAN COO, AOL TIME WARNER	Runs the Pilot Group, which v invest in radio and TV station
THOMAS MIDDELHOFF CEO, BERTELSMANN	Heads Investcorp's European g with holdings in Saks and Tiff
STRAUSS ZELNICK CEO, BMG ENTERTAINMENT	Heads Zelnick Media, with sta in Columbia Music Entertainm in Japan and National Lampoo
THOMAS E. DOOLEY **PHILLIPPE P. DAUMAN** DEPUTY CHAIRMEN, VIACOM	Running DND Capital Partners with an investment in the Ten Channel
FRANK J. BIONDI JR. CEO, UNIVERSAL STUDIOS	Operates Waterview Advisors, with a stake in Stagebill and also in the Tennis Channel

CONTRIBUTED BY TOM LOWRY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Up Front

PROFIT AND GLOSS

CLEANING UP ON THE AUDIT CRACKDOWN

ONE YEAR AFTER THE JULY 30 signing of the Sarbanes-Oxley Act of 2002, the law designed to clamp down on auditing firms has in fact made them richer. Audit fees are up 25% to 33% this year, says Paul R. Brown, a professor at New York University's Stern School of Business. Auditors are responding to the law with expanded reviews of corporate controls and greater efforts to discern fraud. "It is ironic," says Brown, who expects auditing firms to post record profits. "Some of the players who led to the problem are really benefiting."

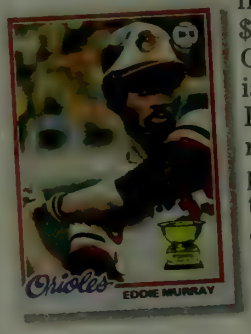
This is just the start. According to a May survey by Financial Executives International, audit fees are expected to jump an additional 35% by mid-2004. That's when companies must assess their internal controls and then have their auditors attest to them.

As private partnerships, PricewaterhouseCoopers, Deloitte & Touche, KPMG, and Ernst & Young don't reveal their earnings. But they say audits have become pricier. They're also more time-consuming—and riskier, given Arthur Andersen's demise. "What we're trying to make sure of is not that we're more profitable but that we stay in business," says Deloitte partner Greg Weaver. Sarbanes-Oxley is certainly helping. *Nanette Byrnes*

SPORTS BIZ

HALL OF FAME BONUS BUCKS

ENSHRINEMENT IN BASEBALL'S Hall of Fame is food for the soul of ex-big leaguers who have spent careers piling up wins or slugging home runs. The honor can also mean big bucks.



Hiring Gary Carter to appear at a sales meeting, for example, used to run about $8,000. Now, the ex-catcher, who enters the Hall on July 27 along with ex-Baltimore Orioles slugger Eddie Murray, charges $20,000 to $25,000. "It puts him in a different category," says Bob Williams, president of Burns Sports & Celebrities, which arranges corporate appearances.

The memorabilia market also can spike. The price of a Carter-autographed ball is up from $35 to about $50 at Kit Young Cards, a memorabilia retailer in San Diego. Murray, who rarely makes appearances, is hot, too. His signature on a ball fetches an extra 15% to 20%, to about $80. Not bad since thousands can be signed at one event.

It's not all about grabbing the green, though. Murray and Carter are donating some of their Hall of Fame spoils to charities. *Mark Hyman*

DRAWN & QUARTERED

HAPPY RETURNS

SWEET REVENGE FOR A RETIREE

A.G. EDWARD & SONS HAS BEEN hit with a $950,000 judgment in the first arbitration ruling stemming from claims that a broker mishandled client accounts.

Last February, *BusinessWeek* chronicled how stockbroker William F. Gibbs Sr. persuaded as many as 90 workers at a Procter & Gamble plant in Augusta, Ga., to quit and transfer their pensions to him to manage. While Gibbs said he would invest only in blue chips, he shifted workers into risky tech stocks—moves that cost some clients almost all of their savings ("Wiped Out," Feb. 24).

GRESHAM: *A sweeping victory*

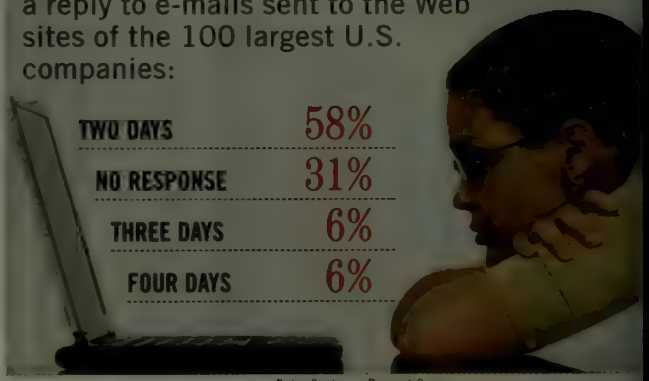
Many of the workers filed claims against Gibbs tration. On July 8, t panel ruled in favor dell A. Gresham, who nearly $265,000 in losse Edwards was told t Gresham's losses plus in legal fees. The pa awarded $400,000 in damages—a big wi arbitrators punitive da only 2% claims.

The rulin foreshadow eries for oth cause Gib many in th stocks. A woman for Edwards sa strongly dis with the d Gibbs deferred quest his lawyer, Peter J. son, who called the "overblown" and is li file a motion to vac award. *Dean*

THE BIG PICTURE

ANYBODY OUT THERE?

Here's how long it takes to get a reply to e-mails sent to the Web sites of the 100 largest U.S. companies:



Data: Customer Respect Group

Polls, surveys, and other items for consideration in this section should be sent to **upfront@businessweek.com**

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Readers Report

ALTERNATE ENDINGS FOR TINSELTOWN'S DIGITAL DRAMA

Certainly there are enough smart people in Hollywood to figure out that revenues and profits will be maximized when first-run movies can be electronically distributed to homes immediately upon release ("Hollywood heist," Cover Story, July 14). The studios should take full advantage of their advertising dollars and charge $30-plus per movie within the first 30 days of release, and scale it back to say $5 after three or four months.

I'll gladly pay $30 to download a movie whose trailer I just saw on TV. Heck, my current cost is $75: $50 for the sitter and at least $25 for the tickets and goodies. Offering newly released movies over the Web could be the greatest thing to happen to Hollywood since the video craze.

Chris Golec
Kentfield, Calif.

Hollywood's problem is too much greed and slow adaptation to the digital world. The Apple iTunes Music Store model proves that consumers will buy products that are priced right. There are simply too many middlemen making lots of money with the old-fashioned distribution model. Instead of rapidly adopting to technological changes and giving us CD and DVD burner kiosks in every mall where we can get what we want at a reasonable price, the entertainment industry hires lawyers and tries to keep the old business model fully functional in the Digital Age.

Martin Grubner
Burlington, Mass.

The fact that CD sales fell durin
period when digital audio techn
became widely available does not
causality. CD sales were kept at "
ural" levels from 1983 to 1999 b
baby boomers, who gradually r
chased, in the new format, mus
ready owned on vinyl. But by
boomers had repurchased all the
rial they ever wanted, including
overlapping compilations conta
many unwanted duplicates. (I cou
less than eight copies of *Hey Pa*
my collection!)

Malcolm H
New

Your article focus
what the victims of
cy must do to p
their product and
income. There wa
discussion of the
morality of the crir
who pirate the mov
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is as if there is no
if it is cybercrime
somehow different
someone stealing a
from the video stor
a delicate suburban stunt as op
to a brutal urban robbery. People
ing movies or audios are criminal
should not praise their ingenuity.

Byron Fu
Ho

The final sentence of "Holly
heist" ends: "...you have to giv
people what they want." What the
ally want is something for nothi
am in the production business, so
very afraid that the product of my
and investment will be stolen by
very petty thieves. Yes, we need t
them what they want, but they

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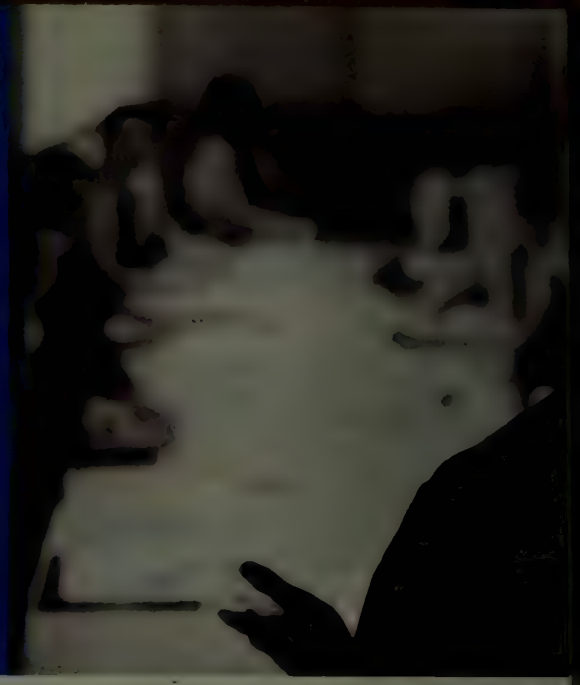

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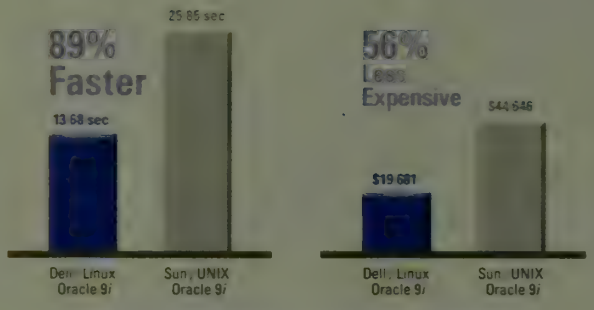

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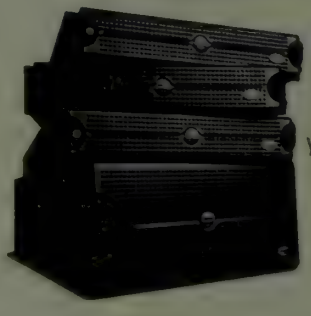

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Based on IDC Quarterly Server Tracker, June 2003. Tests by Dell in January 2003 on baseball database. Dell configuration: Dell PowerEdge 6650 server with four 2.0 GHz Xeon MP processors, Red Hat Linux Advanced S Year Gold Support. Price: $19,681 (www.dell.com, 7/1/03). Sun configuration: Sun Fire V480 server with four 900 MHz UltraSPARC III processors, Solaris 9 (12/02 version), 3 Year Gold Support. Price: $44,646 (www.sun.c For details and results, see www.dell.com/migration.

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eaders Report

RECTIONS & CLARIFICATIONS

global companies" (Special Report, July wroneously stated that HSBC Holdings cquired Safra National Bank. What acquired in December, 1999, was Re- New York Corp. and its sister company, Republic Holdings.

y Weill's legacy" (Editorials, July 28) ectly included Golden West Financial ist of acquisitions by banker Sanford ll.

k options: The fuzzy new math" (Man- ent, July 14) misstated the impact of sing the risk-free interest rate as- ion when calculating the Black-Scholes of stock options. Increasing the as- tion will increase option values.

nse options—but give startups a " (News: Analysis & Commentary, July correctly described Joseph Blasi as an mics professor. He is a sociologist at rs University. Also, the research re- to in the article was conducted with lleagues Douglas Kruse, James Sesil, aya Kroumova.

e rise of the reds" (BusinessWeek In- July 21), chablis was characterized as t wine—and much of the chablis mar- in the U.S. is. However, the wine that from the Chablis appellation of France Also, in the accompanying "Tastings" on of red wines, the syrah depicted isidentified. It is an Edna Valley syrah.

w to tickle a child" (Marketing, July 7), me of Nickelodeon's general manag- misspelled. The correct spelling is Zarghami.

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pay for it. If they don't pay for give them a lot of what they want—fines and jail time!

Richard L. Jessup
Sage Road Productions
Houston

college student, I have been ex- o this wave of "piracy" that you as crippled the music industry w moves to strike the movie in- The movie industry spends bil- f dollars on steaming piles of " expressions, lies to us through tire advertisement phase, and onders why people don't want $10 to see it at the movies. They lty of the same price-gouging as the music industry. To me, ge in piracy has been just the wake-up call the movie and music industries need.

Nathan Hough
Fresno, Calif.

In 2002, Taiwan's Joint Optical Disk Enforcement Taskforce, with members from the Public Prosecutor's Office, police departments, and other ministries, conducted 297 inspections of optical disk manufacturers ("Tinseltown's aim: To catch a thief," Cover Story, July 14). Of these, 157 were random inspections, and 33 were carried out at night, after regular production hours. Sixteen of the raids were successful, resulting in the seizure of eight manufacturing machines and 1,130,000 pirated disks. Fifteen illegal optical disk manufacturers were closed permanently.

Jung-tzung Yih
Director, Information Div.
Taipei Economic & Cultural Office
New York

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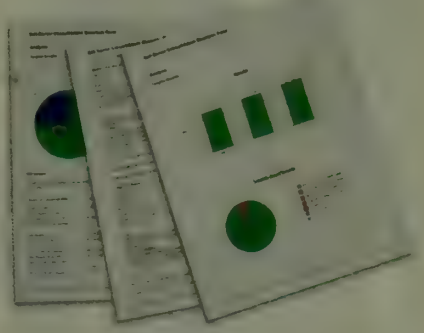

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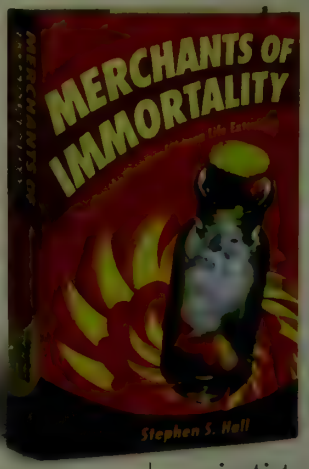
MERCHANTS OF IMMORTALITY
Chasing the Dream of Human Life Extension
By Stephen S. Hall
Houghton Mifflin • 439pp • $25

WHO WANTS TO BE A 150-YEAR-OLD?

To me, fantastic science has been only part of the story of the biotechnology industry. An equally compelling aspect is that the industry's fundamental aim is to yank the Grim Reaper's chain.

For decades, biotech evangelists have spun hope into gold, constantly declaring themselves to be on the brink of dramatic, life-saving medical advances. More often than not, plans haven't panned out—or have had a more limited payoff than first imagined. Then, entrepreneurs have come up with new schemes, describing why even newer discoveries put them in an even better position to find cures. Over time, this approach has raised huge amounts of investment capital and overcome many setbacks. By the early 1990s, numerous biotech companies, such as Amgen, Genentech, and others, had developed good drugs and vaccines that extended or saved lives.



At the same time, however, some scientists and entrepreneurs began openly exploring the idea that cheating death one limited advance at a time was the hard way to go: Instead, they sought to short-circuit specific aging-related genes that appear to hijack the healthy, vibrant tissues of our youth. That work led, in turn, to attempts to harness fetal and embryonic cells that scientists hoped could rejuvenate or replace diseased or worn-out body parts.

This modern band of Ponce de Leóns comes to life in the intensely researched and well-written *Merchants of Immortality: Chasing the Dream of Human Life Extension* by ace science writer Stephen S. Hall, author of *Invisible Frontiers: The Race to Synthesize a Human Gene* and other books. Hall illuminates the science and the scientists, their financial as well as ego-based motivations, and the often capricious politics that accompany their efforts.

This is an ambitious book. At times Hall includes too many themes many minor players. But thes don't lessen the rich and nuan derstanding he brings to endeav embrace some of society's most dreams and its thorniest ethical

For starters, Hall makes the cated and sometimes tedious r ics of both biology work come alive. er his poetic treat humble nematodes as *Caenorhabditis* "When viewed thr microscope," he wri worms "appear to l purpose in life but lessly carve sinuo besques in their media, their mov mesmerizing and be Studying these cre a team of Univer California at San Fr scientists led by Cynthia J. made a remarkable discovery: B ing a single gene in the worm they could quadruple its life spa change one gene and the whole all the tissues, looks good," she es. While she realizes some sc may disagree, Kenyon tells H she believes the same sort of fai ple genetic jujitsu might prolo man life, too.

Hall has an obvious passion ence, but he is realistic about h mans and university and corpora work: Both are driven by egos a ey. For example, when research ing starts getting hot, he notes by land, sea, and air, the field is by researchers scrambling for a the action, pursuing their inte curiosity with all the decorum a nity of those 19th-century gen geologists who pursued their c about rumors of gold in Californ

Merchants of Immortality several fascinating figures in th of aging research, most notably L Hayflick, the father of "molecular tology," who first discovered th are preprogrammed to replicate

er of times. There's also Michael D. , founder of Geron Corp. and now of Advanced Cell Technology. Once vent religious fundamentalist, West n about-face, embracing evolution- biology and becoming one of the aggressive proponents of human ıg and fetal-cell research. Hall calls a "Zelig of modern biology" who vet to discover or shepherd any advances to market but who re- dly appears at congressional hear- and press conferences making ıcative claims about controversial rch. West is not alone in this be- r: Many biotech executives feel the to be promotional because of high rates and slow progress.

ıally, Hall raises many important ophical issues. He makes clear that we are a long ways from seriously lengthening our life spans or being able to order a new ticker from sparehumanparts.com. However, 75 million baby boomers' force of will, along with the determination of scientists to push knowledge forward, are likely to overcome political hurdles blocking promising research. That will raise such questions as: What are we willing to do, and to spend, to help people live to be 150—even if much of the last third of that life span may involve an endless array of soft foods and a search for attendants who speak loudly and slowly? Hall's book provides powerful, well-written background for those discussions.

BY JOAN O'C. HAMILTON

Hamilton is a formerly young technology writer.

K BRIEF

IDDEN LANGUAGE OF BASEBALL
igns and Sign-Stealing Have Influenced urse of Our National Pastime
l Dickson
• 230pp • $22

AMOND SPIES

every ballpark across America, here's a game within the game ew off the diamond can penetrate: urry of signs and signals that dic- he pitch, align the defense, in- the batter, and cue the runners teal, squeeze play, or hit-and-run. *e Hidden Language of all*, Paul Dickson doesn't d to teach his readers o catch and interpret all gns—1,000 or more in ame—that fly across the But if you absorb even a n of the information in les of baseball's silent gy and how teams have t to win games through cades, your next trip to llpark will be consider- icher.

ıally, most of this book isn't about g, but about its evil twin, sign- g. Dickson details dozens of meth- ams have used to capture and de- essages—from Bob Feller's World l telescope to a hunchbacked bat alleged peeking under catchers' and the psychological warfare that ers wage. As early 1900s Hall of pitcher Christy Mathewson wrote Philadelphia Athletics' owner- er: "I do not believe that Connie players steal as much informa- they get the credit for, but the tion itself, if they never get a valuable."

Sign-stealing reached its peak—or depths—in the scoreboard-spy era of the '50s. The home-team advantage often included a reserve catcher with binoculars stashed inside the scoreboard to catch opponents' signals and relay them to the dugout. But even a public controversy over whether Bobby Thompson was tipped off on the fastball that he sent out of the Polo Grounds—the famous "The Giants win the pennant!" homer of 1951—couldn't force baseball to overcome its ambivalence and actually outlaw egregious sign-stealing. (The consensus verdict, when the charge was first made in 1962 and when it was revived in 2001: The Giants had spies with binoculars relaying signs via a buzzer in the dugout in '51, but Thompson didn't take any signals.)

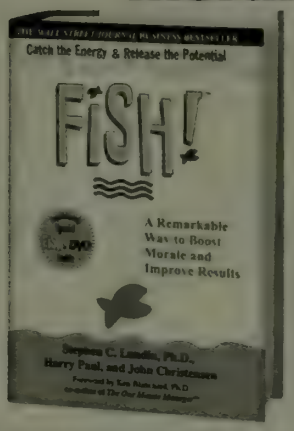
Today's unwritten code: Players and coaches on the field can do almost anything to break opponents' codes, provided they don't use mechanical aids or allies outside the fences. Almost anything—because a batter's attempt to peek at where the catcher is setting up for a pitch "will likely bring the next pitch high and inside" in retribution, Dickson writes.

With binoculars barred, today's players and managers focus on "tips"—unconscious moves by pitchers, catchers, or coaches that give away opponents' next moves. In Game Six of the 2001 World Series, the Arizona Diamondbacks picked up the differing hand motions that New York Yankees lefty Andy Pettitte used for fastballs and curves when pitching from the stretch. The D'backs won 15-2—and went on to capture the series. Today as much as in the '50s, "a good sign-stealer can always get a job."

BY MIKE McNAMEE

Command performance

Improve morale



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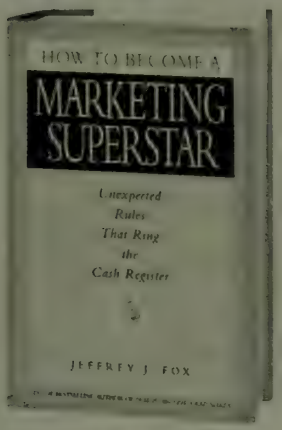

Learn to Out Fox the Competition

Bring customers back for more

"A gem."
—The New York Times

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BY STEPHEN H. WILDSTROM
tech&you@businessweek.com

TABLET PCs: GETTING BETTER, BUT...

Windows for Tablets still falls far short of its potential—and may continue to until 2005

When Microsoft's Tablet PC made its debut last year, it seemed a bit like a solution in search of a problem. Notebook computers and slates that let you enter data in handwriting and store it either as "digital ink" or convert it to text had a big "wow" factor, but it was hard to see their practicality outside of some specialized markets. While I still think it will be a couple of years before Tablets become truly mainstream products, new hardware and software show glimmers of an interesting future.

The big hardware news is the release of a low-voltage version of Intel's already power-thrifty Pentium M processor. I tried a Gateway-branded version of the Motion Computing M1300 Tablet, which features about a 15% boost in battery life, to a bit more than three hours—an improvement, but still not enough—and a considerable bump in speed. Handwriting recognition and Tablets' heavy use of graphics demand a lot from a processor, and the first models were sluggish. Expect new Pentium M-based Tablets this year from Hewlett-Packard, Fujitsu, Toshiba, Acer, and Sharp.

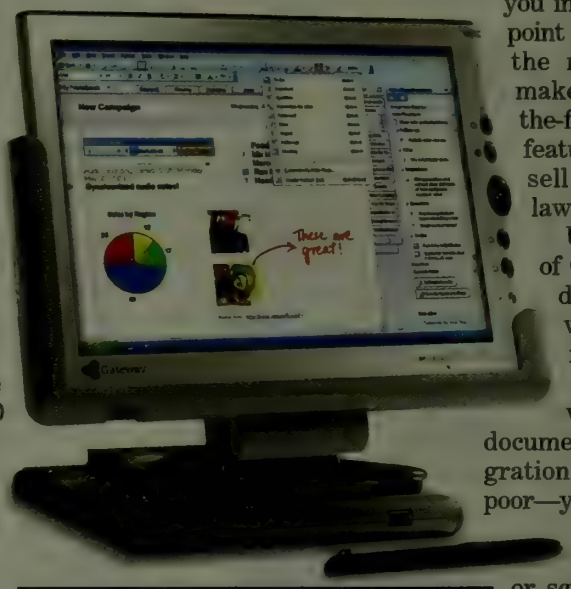
The software is a bigger leap. MindManager 2002 from Mindjet shows how far Microsoft's Tablet version of Windows falls short of its potential. MindManager is a brainstorming program that lets you create graphical maps of ideas or a plan. Say, for example, that you're creating a "mind map," a sort of free-form outline, for the marketing of a new product. When you realize you need a new section for a product brochure, a quick horizontal flick of the pen at the end of an existing section of the outline creates a new action item. Similar "gestures" with the pen let you accomplish tasks such as deleting and moving sections of the map without jumping all over the screen to click on icons and menu choices. The program offers an easy to convert some or all of your handwritte tries to text. It takes a while to learn the tures, but once you do, Tablet use bec much more efficient.

Microsoft itself shows some real progress new application called OneNote, an add- Office 2003, which is due out this fall. OneN a note-taking application that lets you cor handwritten or typed notes with drawings, ed-in pictures, Web pages, or just about other sort of data. Handwritten notes ca converted to text or left as ink.

One of the most interesting featur OneNote is its integration with the Tablet's in voice recorder. Any notes you take recording are automatically linked to recorder's time code. If you later click on th that represents a loudspeaker next to the you immediately jump t point in the recording v the note was made. makes your notes a the-fly index to the au feature that by itself sell a lot of Table lawyers and journali Unfortunately, the of Office 2003 doesn't dle the Tablet nea well. Word mak reasonably easy t clude a sketch or written comment document. But the pen gration in Outlook rer poor—you cannot, for exa add a handwr note to a mes or scribble a quick app ment in the Outlook dar. If you're using the you must use Micro clumsy "text input pan convert your handwriti text or tap away usin on-screen keyboard.

Windows, on its ow sists on treating the p little more than a m Smarter software w have the sense to at open the text-input when text entry is c required, but now you have to do it man And the text-input panel stays glued to the tom of the screen instead of appearing ne where text is being entered. Some improven to the Tablet software are due with a Win XP service pack next year, but a real ove won't come until the "Longhorn" version of dows arrives in 2005.

Bill Gates likes to call the tablet the futu personal computing. He may be right, Microsoft could be doing a lot more to ma happen.



Gateway Tablet PC

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- 12.1-IN. DISPLAY
- 11.7X9.4X0.9 IN., 3 LB.
- $2,300
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Data: Gateway

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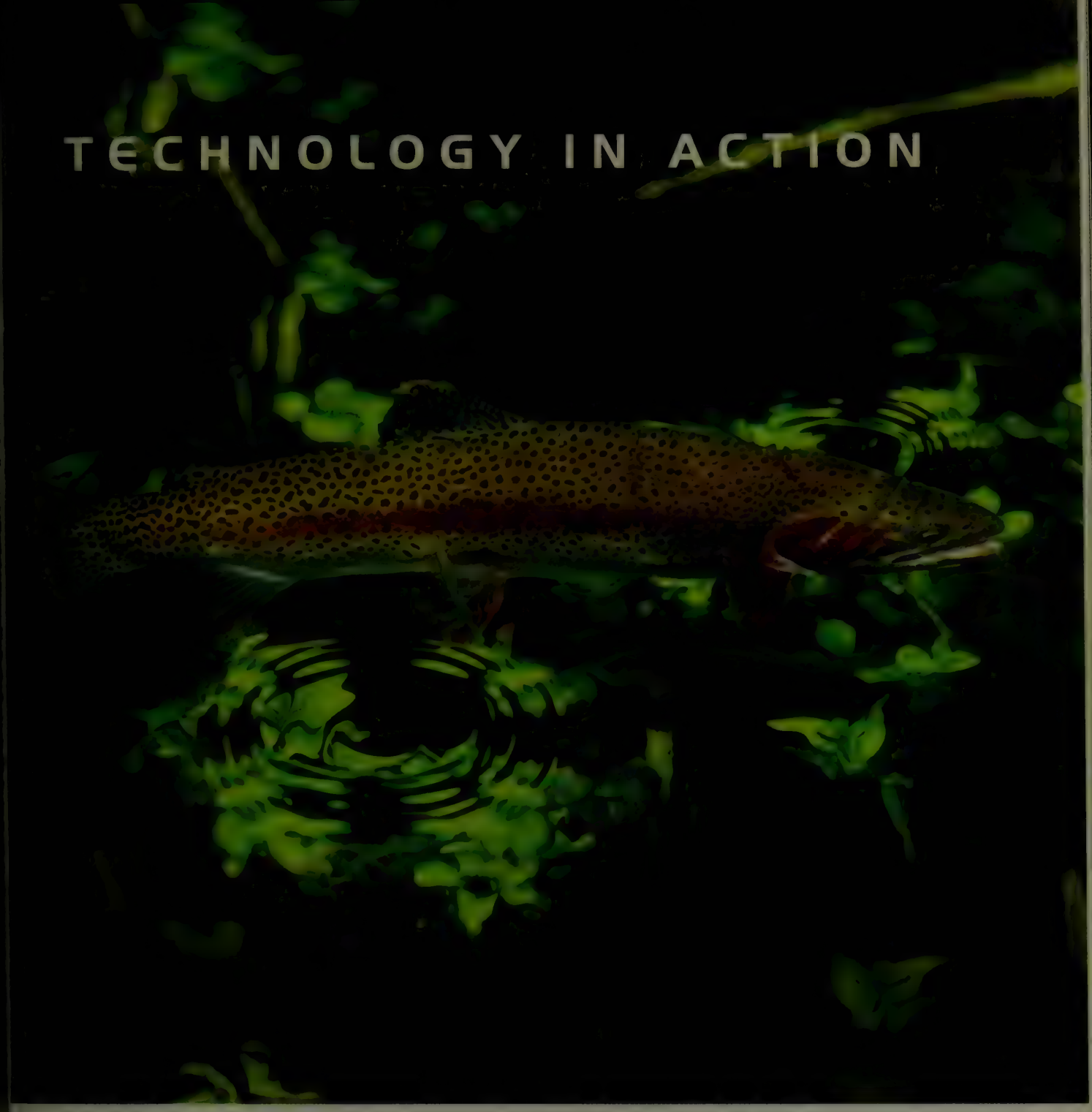

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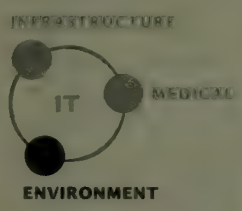

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BY GARY S. BECKER

HOW TO LEVEL THE PLAYING FIELD FOR YOUNG BLACK MEN

SLANTED: Improved schools are crucial. But until the U.S. can bring itself to decriminalize drugs, too many black sons will have no dad at home

Gary S. Becker, the 1992 Nobel laureate, teaches at the University of Chicago and is a Fellow of the Hoover Institution.

Just about 60 years ago, Gunnar Myrdal, a Swedish economist who subsequently won the Nobel prize, published a highly influential book, *An American Dilemma*. The title referred to the conflict between America's belief in equality of opportunity for all and the widespread, often vicious, discrimination against descendants of African slaves. The recent Supreme Court ruling upholding affirmative action provides a convenient point to assess the uneven progress made toward solving this uniquely American dilemma and to consider possible measures—including increased aid for education and a decriminalization of drugs—to improve the situation of African Americans.

Myrdal showed that, as of the early 1940s, blacks were segregated in all regions of the U.S., especially in the South, where most lived. Blacks fell short of whites in education, income, health, housing, and opportunities. They were generally not fairly treated by the justice system and effectively could not vote in much of the South. Fortunately, in all these dimensions, African Americans have made enormous strides toward greater equality with white Americans.

The federal government abolished school and other segregation laws during the '50s, and the racial gap in years of schooling has narrowed a lot. Racial differences in life expectancy and other dimensions of health have also been greatly reduced. Half a century ago, most black women worked as servants, and black men were employed predominantly in unskilled occupations. Now, many men and women have advanced into clerical, skilled, and executive positions, including the first black Secretary of State, mayors of important cities, and chief executives of a few leading companies. The earnings of working black women almost equal those of white women, while the earnings shortfall of black men has shrunk.

But the news is not all good. For example, the male earnings gap is still about 25%, and the racial difference in earnings for both sexes has hardly contracted since the mid-1980s.

Moreover, in two disturbing respects the difference between the races has widened during the past few decades. Black families were quite stable until the '60s, if not quite as stable as those of whites. Although divorce and unmarried motherhood have increased throughout American society, they have exploded among blacks. Well under half of black children are in two-parent families, sharply down from about 75% in 1950, although there has been a little improvement since the mid-1990s.

The second concern is the huge increase number of black men in prison. They ma more than 40% of male prisoners, compare about 12% of the overall population. For incarcerated on drug-related charges, the share is almost 60%. Only a slim majority of black men are not in prison, on parole, bail, bation, or have not been arrested at least

There's reason to believe this shortage sirable male companions discourages women from marrying or staying marri long. The downward spiral is self-perpetu Studies suggest that the decline in the pr of fathers in black families harms sons than daughters. As a result, the rapid gro the number of black men in prisons impai following generation of black males as we

The challenge is to find effective ways t row the gap between the circumstances of blacks and whites. Of course, increasing th bility of black families should have a high ity—as the late Senator Daniel Patrick Mo recognized several decades ago. Unfortu some states still make it difficult for two-p families to collect welfare. Especially fo families, the tax laws should provide an benefit to intact families, instead of pun them as these welfare laws do.

A longer-run reform would be to impro schooling of young blacks, since their ea still trail those of whites, partly because growing economic advantage of a good edu That improvement will not be easy wh many black families are without two pa but an expanded Head Start progra greater competition among schools in the city through vouchers and charter schools help. Among other things, competition produce more schools that cater to the needs of black males.

Finally, the time has come to decrimi drugs. Trafficking in drugs attracts young mainly because it offers much better pay vided they don't get caught) than do the le ternatives, which tend to be low-wage jobs. conservatives and liberals who are reluct make drugs legal have to recognize tha present system does enormous damage t black community, especially to the many men who spend years in prison on drug ch

The American racial dilemma of a half-ce ago has been much eased, but a large ineq between young black and white males That should become the main focus of policies on racial questions.

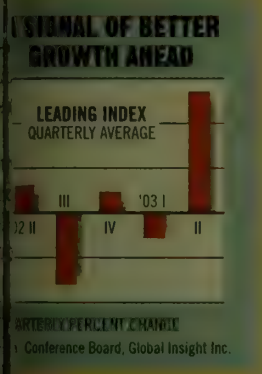
JAMES C. COOPER & KATHLEEN MADIGAN

HE ECONOMY GETS SOME ET-UP-AND-GO

e recovery is gaining momentum as rate and tax cuts kick in

U.S. ECONOMY

If you compare the way the economy looked at the end of second quarter with how it looked at the beginning, would never believe it was the same quarter. It's economic makeover that is almost certain to im- ve the looks of the third quarter and set the re- ery onto a faster growth track heading into 2004.



What's different now is the economy's momentum. This forward movement is captured in the pattern of the monthly data, since the figures for real gross domestic product are generally averages of the monthly numbers. Sometimes momentum is more important than the quarter's overall growth rate.

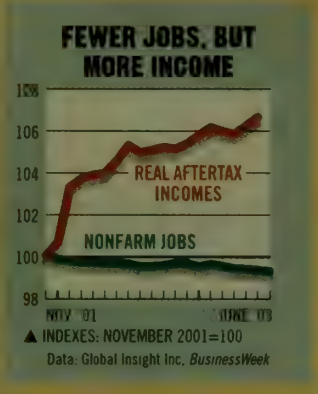
This is one of those times. ries about the Iraq war caused households and nesses to freeze in March and April. That paralysis ne end of the first quarter and at the start of the nd sealed last quarter's fate. As a result, second- ter real GDP appears to have grown at an annual of about 1.8%. That's the uninspiring forecast d of the Commerce Dept.'s official tally on July 31. owever, the latest monthly data show a reversal in mics for the third quarter. For example, manufac- g output, down in March and April, has risen for months in a row. Retail sales, which fell in April, ased strongly in June. Plus, surveys of manufac- g and retail activity in July point to further gains. shift of momentum is especially evident in the x of leading indicators (chart).

oreover, any third-quarter bounce in the economy not be a one-shot deal. Growth should accelerate in ourth quarter and into 2004 as long as the strong in demand finally puts an end to the skittishness of utives. A return to corporate risk-taking, in the of inventory building, new capital spending, and g, will complete the virtuous cycle that kicks this very up a notch.

THAT TO HAPPEN, companies will have to per- any pickup in demand as durable and not just a in the pan. Executives will need plenty of con- ng before they set aside all of the uncertainty has hung so heavily over corporate board rooms for the past three years. And clearly, the supports under domestic demand augur well for a sustained advance in the second half.

Here's why. First and foremost, improving financial conditions, which are the grease for the recovery's gears, are the most supportive they have been in three years. The Federal Reserve's massive cuts in interest rates have taken both short-term and long-term borrowing costs down to levels not seen since the 1950s. As a result, corporate finance is returning to normal, investors are willing to take on more risk, and activity in the corporate bond and stock markets is picking up.

Corporate America is also reaping the benefits of past cost-cutting and improved efficiency. With 158 of the companies in the Standard & Poor's 500-stock index having reported second-quarter earnings, two-thirds have exceeded forecasts, the most in more than three years.



Moreover, analysts have stopped cutting their expectations for future earnings, according to researchers at Prudential Securities. They note that Street analysts consistently slashed their earnings projections in almost every month since 2000. The same was true last year for 2003 projections, but over the past five months, the average 2003 forecast for S&P 500 operating earnings has stabilized at about $54 per share, and some analysts are now starting to raise their projections.

HOUSEHOLDS ARE ALSO BENEFITING from easier financial conditions. Thanks to low mortgage rates, extra cash is flowing from refis. And the broad Wilshire 5000 stock index jumped 16% during the second quarter, undoubtedly brightening the faces of a lot of workers when they opened up their 401(k) statements.

Also, tax cuts hit workers' paychecks in July. The boost to aftertax incomes for the third quarter alone is estimated to be some $35 billion, and Federal Reserve Chairman Alan Greenspan recently testified that the second-half lift to incomes will be "considerable" even after accounting for expected state and local tax offsets. The tax cuts will provide a strong bridge for consumer spending until job growth picks up (chart).

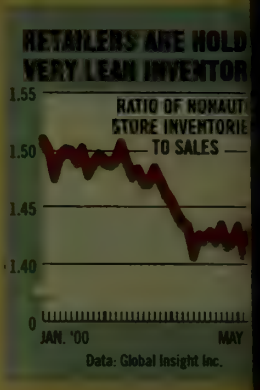
How do we know that? Because the two prior rounds

of tax cuts in 2001 and 2002 have done just that. Since the recession ended, payroll jobs have fallen by 0.7%, but households' real aftertax income has risen 6.6%. That has allowed real consumer spending to increase 4.2%, while leaving room for the savings rate to rise from 0.9% to 3.5%. And the 2003 tax cuts are far larger than those in the previous two rounds.

ON BALANCE, THIS POWERFUL MIX of stimulants should keep demand growing. And sustained sales gains should prompt businesses, especially retailers, to start restocking supplies and merchandise (chart). Inventory rebuilding is another key component of a strong recovery. But so far, companies have been keeping inventories extremely thin. Excluding the ups and downs of inventories on car dealers' lots, the ratio of business stocks to sales has been at record lows for more than a year.

Thanks to technological and management innovation, businesses have reduced the amount of inventory they typically carry. But this year's average ratio of nonauto stocks to sales is well below the trend of the past decade. With inventories so low, the coming pickup in demand will have to be met with a rise in production. That might already be happening: Manufacturing output increased in May and June, the first back-to-back gains in a year.

Of course, a true and lasting recovery depends on capital spending. Businesses are still extremely hes to invest, but even here the outlook is the best it been in many years. Stronger profits and more fa able financial conditions are a good framework.



Companies also have concentrated on reducing excess production capacity. Indeed, among nonfinancial corporations, the ratio of depreciation to new capital spending last year was the highest in the post-World War II period. The rapid rate at which capital goods are wearing out suggests there may be increasing pent-up demand for equipment, which will be satisfied once businesses see mand for their products grow faster in the second

Of course, the U.S. economy has been here be Real GDP has performed impressively for a qua only to flame out in succeeding months, as growth stunted by successive corporate scandals and war Iraq. In fact, the National Bureau of Economic search declared on July 17 the recession ended bac November, 2001, implying that the economy has bee an upturn for a year and eight months. But only are the typical cyclical forces which spur demand promote stronger growth starting to fall into plac

MEXICO

HOSTAGE TO ITS NEIGHBOR'S TROUBLES

Weak demand in the U.S. is becoming a big problem for Mexico's manufacturing sector.

Total Mexican industrial production in May was down 2.3% from a year ago. Construction and mining posted solid gains, but factory output fell 3.5%. The factory weakness reflects a drop-off in exports. Total manufactured exports so far in the second quarter are down 4.7% from a year ago, and most of the decline is due to falling exports to the U.S., Mexico's largest trading partner.

Two key problems are hurting Mexico's sales across the border. First, the peso has been rising against the dollar. Although it has fallen a bit from its high set in February, the peso is still 7.5% stronger than it was a year ago.

Second, Mexico's auto industry depends heavily on Detroit's Big Three, who have been losing U.S. market share. Research firm CreditSights Inc. says that in the second quarter of 2000, Mexico was exporting 125,000 vehicles per month, mostly to the U.S. and Canada. Now the monthly rate is down to 108,000, a drop of 14%.

Sagging exports are starting to fall back on the domestic economy. Retail sales edged up only 0.2% in the year ended in May. And banks are lending, but loan demand is weak despite historically low interest rates. That's because consumers and businesses are wary the economy will not rebound until the U.S. economy picks up significantly. Private analysts expect the Mexican economy will probably grow by 2% or less in 2003. Although that's better than the 0.9% gain in 2002, it will not be fast enough to keep the jobless rate from rising from June's official 3.2%.

Interest rates have been falling to levels more in line with U.S. rates, thanks in part to Mexico's continuing fiscal discipline. But any further government help will be delayed. Fiscal and labor reforms are all on the back burner until the newly elected lower house of Congress takes office in September. Expectations are that the U.S. economy will be strong by then, allowing Mexico's export sector to boost economic growth and hiring plans.

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sNexis must search billions of records to deliver access to authoritative news, legal, and
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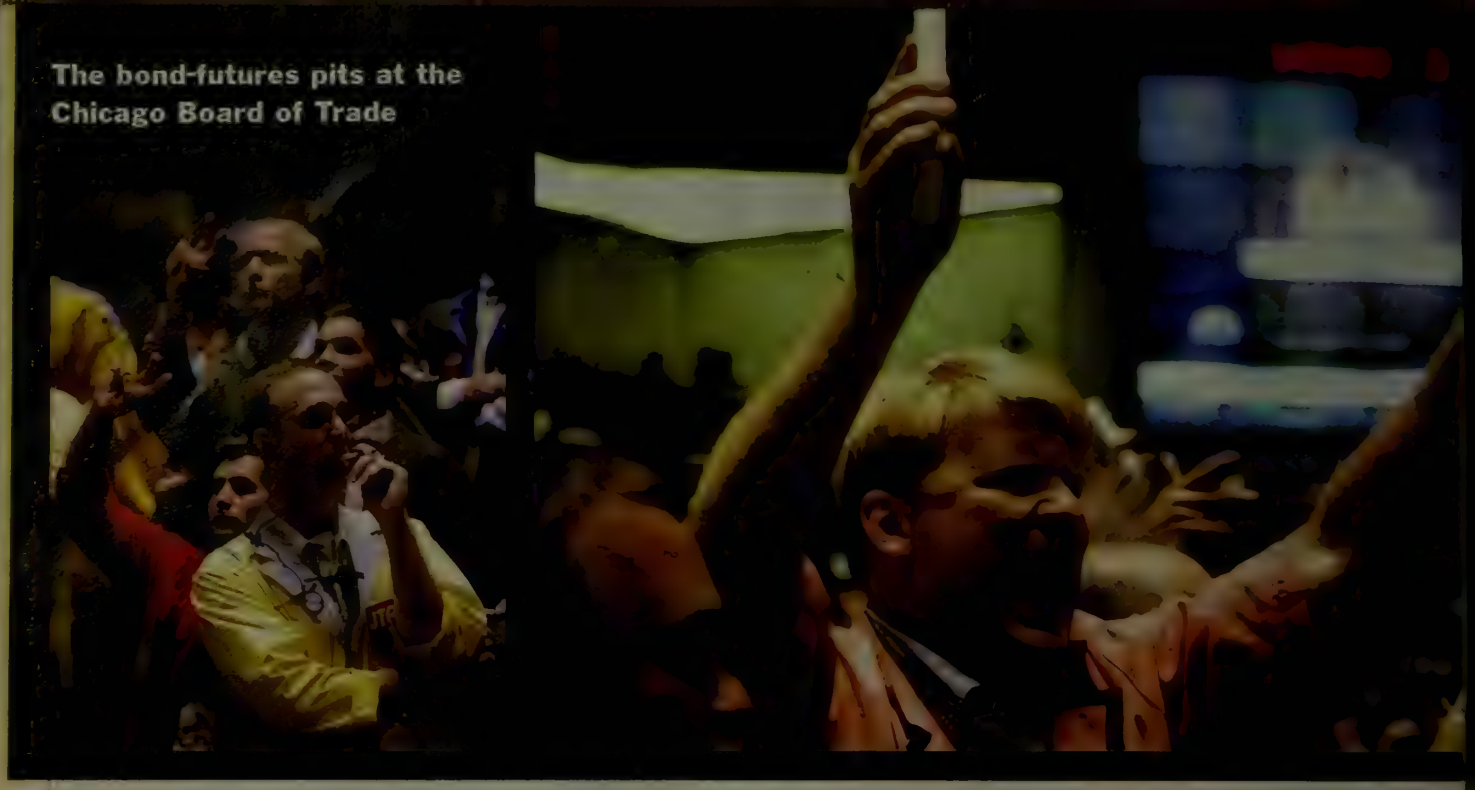
e of its new search programs because of the superior response times to customers and
support costs compared to other operating systems tested.
Windows Server 2003



The bond-futures pits at the Chicago Board of Trade

News: Analysis & Commentary

WHAT BONDS ARE SAYING

The spike in rates could be just the beginning if inflation fears erupt

June 13, 2003—Friday the 13th—will likely go down in the record books as the frothy top of one of the biggest bond market bubbles in modern American finance. In the weeks since, the abrupt sell-off in government bonds has caused interest rates to shoot up a full percentage point to above 4% on 10-year Treasury notes. "We saw the generational low," says David R. Kotok, president of Cumberland Advisors Inc., a money manager in Vineland, N.J.

So far, the rise in rates isn't too worrisome because it appears to reflect a receding fear of deflation and growing confidence about the strength of the economy and the demand for loans. With economists scrambling to raise 2004 forecasts for GDP growth—Goldman, Sachs & Co., for example, has upped its projection to 3.3%, nearly a percentage point more than as recently as June—it's only natural that rates would rise.

Still, there are potential dangers ahead. Even with the recent sell-off, today's interest rates still reflect an assumption that inflation will remain very low and perhaps even drop a bit more. But the massive fiscal and monetary stimulus pumped into the economy is likely to rekindle inflation down the road and increase the supply of bonds. So rates are likely to move higher: Kotok predicts that the 10-year Treasury will be trading at yields of 5.5% to 6% within two years, up from the 45-year low of 3.11% in June.

If rates rise because the mark
gins to see inflation as a bigge
than deflation, that could slow t
covery—particularly if mortgag
nancing screeches to a halt. "The
gitimate nervousness about wheth
rate runup is going to temper th
ing recovery," says Douglas G. D
chief economist at the Mor
Bankers Assn. Worse, rates could
shoot on the way up because of
cal factors and changing sentimer
as they overshot on the way dow

Policymakers at the Federal R
are somewhat surprised by the
runup in rates since they think
tion remains well under control
July 23 speech in La Jolla, Calif
Governor Ben S. Bernanke ford
set out the Fed's view that the
of a further fall in inflation out
those of resurging inflation. He
that the Fed's favorite inflation
eter—which tracks personal con
tion expenditures, minus food and
gy—might fall a half-point mo
roughly 0.7% by the end of 2004.
because Bernanke believes that
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to soak up all the excess producti
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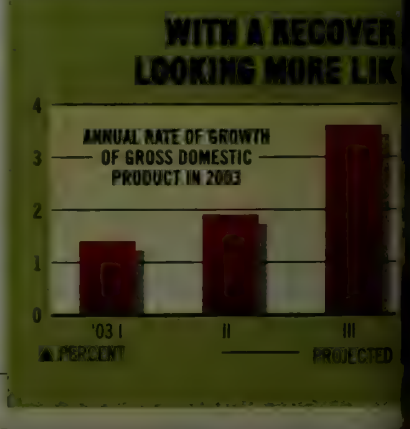
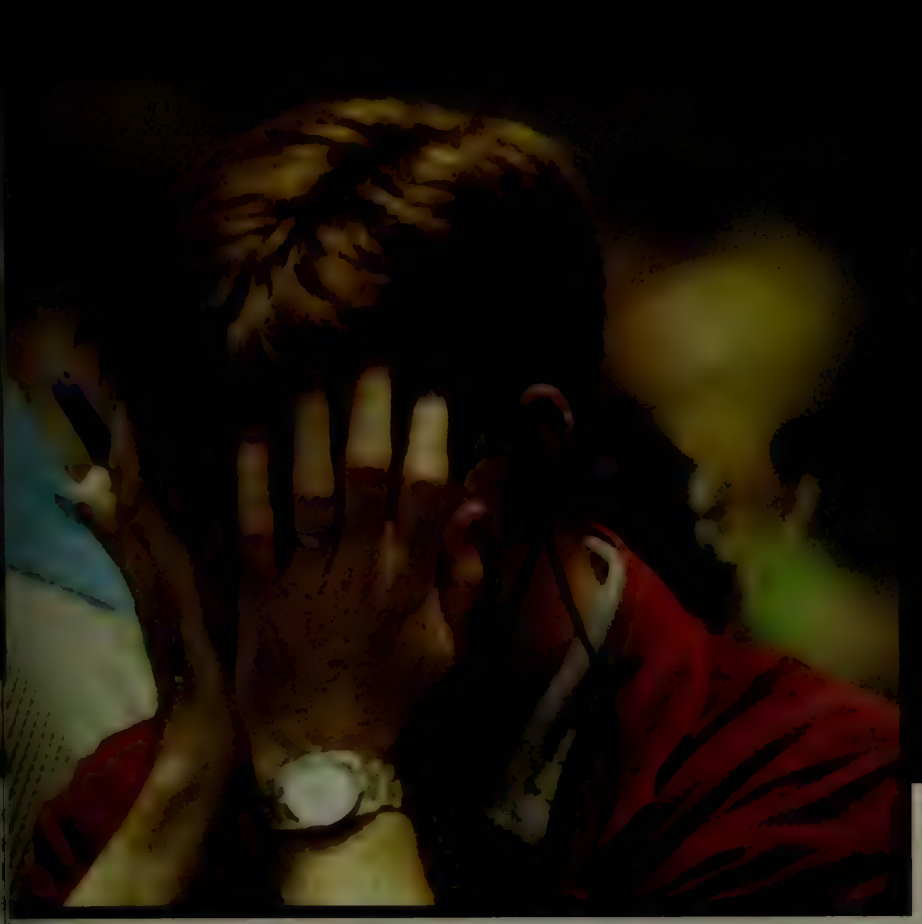




t the credit markets seem to be g out the Fed and its deflation ings: The yield on 10-year notes ust one-hundredth of a percent, 1%, the day of Bernanke's speech. Fed has gone from being per- l as all-powerful to being viewed ically," says Louis Crandall, chief mist at Wrightson ICAP LLC.

tead, the market's attention is y swinging toward early signs that ion may not be dead after all. broad measures such as the pro- price index and the consumer index aren't accelerating, produc- ices for intermediate-stage mate- minus food and energy, have been at an annual rate of better than is year. That's a sharp contrast the first half of 2002, when they falling over 1% a year. Those could be exacerbated if foreign tors decide that inflation risks g the value of their U.S. invest- . In the 12 months through May, ners added $620 billion to their gs of U.S. Treasury, agency, and corporate bonds. If they were to sell off in a big way, it would push down the dollar, raising import prices and feeding inflation.

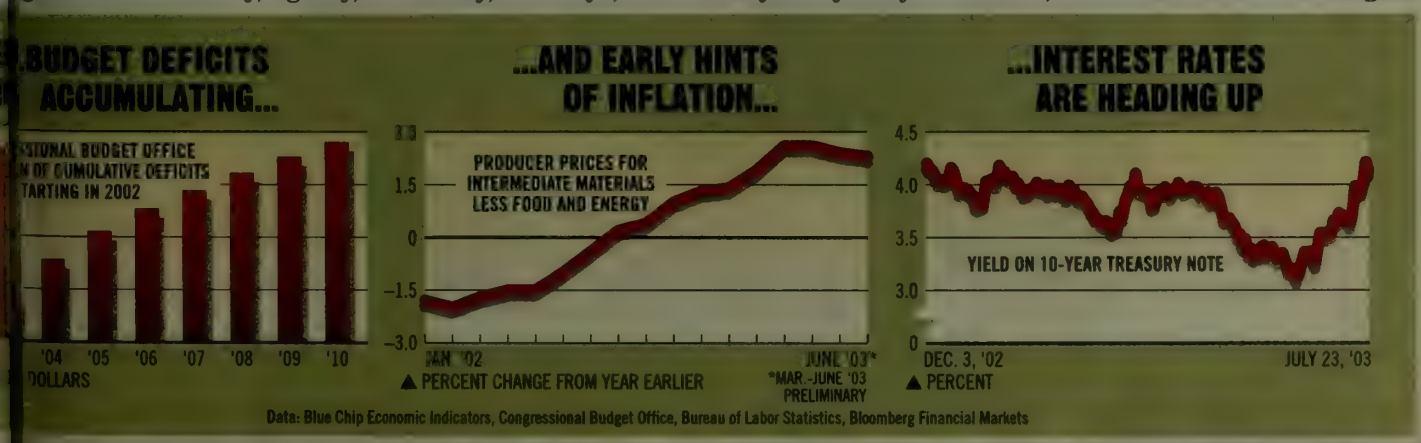
Inflation could also rise because of the sheer amount of money being pumped out by the Fed. Growth in the money supply is up by about 7% annually over the past 2½ years—more than double economic growth. That means more money is chasing goods, says David L. Littman, chief economist at Detroit-based Comerica Bank: "You can't increase money at these rates and expect inflation not to accelerate."

Another reason to expect higher prices is that the Fed wants modestly higher inflation to grease the wheels of commerce. Fed policymakers have been spooked by the brush with deflation and realize they let inflation get too low, says Brandeis University economist Stephen G. Cecchetti, former research director for the Federal Reserve Bank of New York. "If you polled the members of the FOMC today," he says, "I bet they'd say they want the CPI at 2% to 3%, whereas a few years ago they would have said 1% to 2%."

Whether or not inflation expectations are the culprit, the rise in rates spells frustration for borrowers who missed their chance to lock in rates at the bottom (page 30). And it's painful for investors who bought bonds at the market's peak, thinking they were a safer bet than stocks. Already, the price of the 10-year note has fallen 9% since June 13. If the yield on the benchmark note rises an additional point, as many expect, prices will fall 7% more.

The most dramatic impact of rising rates will be the crimping of Americans' ability to turn their housing wealth into cash. Goldman estimates that "mortgage equity withdrawal"—including refinancing and home-equity borrowing—has added spending power equal to about 4% of disposable income. But refi activity has already slowed a bit. And Goldman economist Edward F. McKelvey predicts that if rates stay at current levels or rise, the drop-off in spendable funds from mortgage-equity withdrawal could slash as much as a point from growth in the coming year.

So far, the stock market is shaking off



Data: Blue Chip Economic Indicators, Congressional Budget Office, Bureau of Labor Statistics, Bloomberg Financial Markets

higher rates. "Yields aren't high enough yet to provide much competition to stocks," says Tom McManus, chief strategist at Banc of America Securities LLC. McManus is steering clients toward stocks that will benefit from a recovery and be relatively immune to rising rates, such as food and beverage companies. Higher inflation, which slams bonds, isn't always bad for stocks. By giving companies more pricing power, "the resurgence of inflation is a good sign for the stock market," argues Brian G. Belski, a market strategist at U.S. Bancorp Piper Jaffray.

Fed Chairman Alan Greenspan and his central bank colleagues would like rates to stay low until the economy is growing briskly. But there's not much they can do about it. True, Greenspan & Co. managed to talk longer-term rates lower this spring when they hinted that the central bank might buy bonds to keep deflation at bay. But the rally soon reversed itself when Greenspan made clear that was only a last-ditch option—a point that Bernanke echoed on July 23. Fed officials are now saying that the higher rates reflect an improvement in economic fundamentals.

Market experts worry that a big reason for the spike in 10-year Treasury yields is that hedging-related selli feeding on itself. Fannie Mae, Fr Mac, and others have been selling suries to offset the impact of r rates on their portfolios of mort backed securities. But that causes ket rates to rise—which forces th sell even more.

Massive debt issuance. Rising gr Early inflation signs. It's not surp that rates are rising. It's surprising ever got so low in the first place.

By Peter Coy in New York, Rich Miller in Washington, M Vickers in New York, and Joseph in Chicago

A FRENZIED RACE TO REFINANCE

Thomas Williams fears he just got left behind. The Washington (D.C.) real estate agent had refinanced his $600,000 mortgage a year ago at an annual interest rate of 5.5% for the first five years, and he had hoped to do even better this summer. His dream: locking into a comfy fixed rate for 30 years. But since mid-June, rates on a conventional 30-year mortgage have jumped by almost a percentage point from a 45-year low of 5.21%. Today, the best he can get is 6.25%. "I'll float for a while and see what happens," he says.

Across the country, mortgage brokers and lenders are gearing up for what could be the last burst of borrowing as consumers race to lock in before rates go any higher. Corporate borrowers are dashing to their banks, too—especially weaker companies with below-investment-grade credit, who are scrambling to take advantage of lower spreads in the junk bond market.

For executives and homeowners alike, the sentiment is the same. "People are saying, 'I'd better get this done before I miss the boat,'" says Timothy M. Bartosh, president of Dallas-based CTX Mortgage Co., a division of homebuilder Centex Corp.

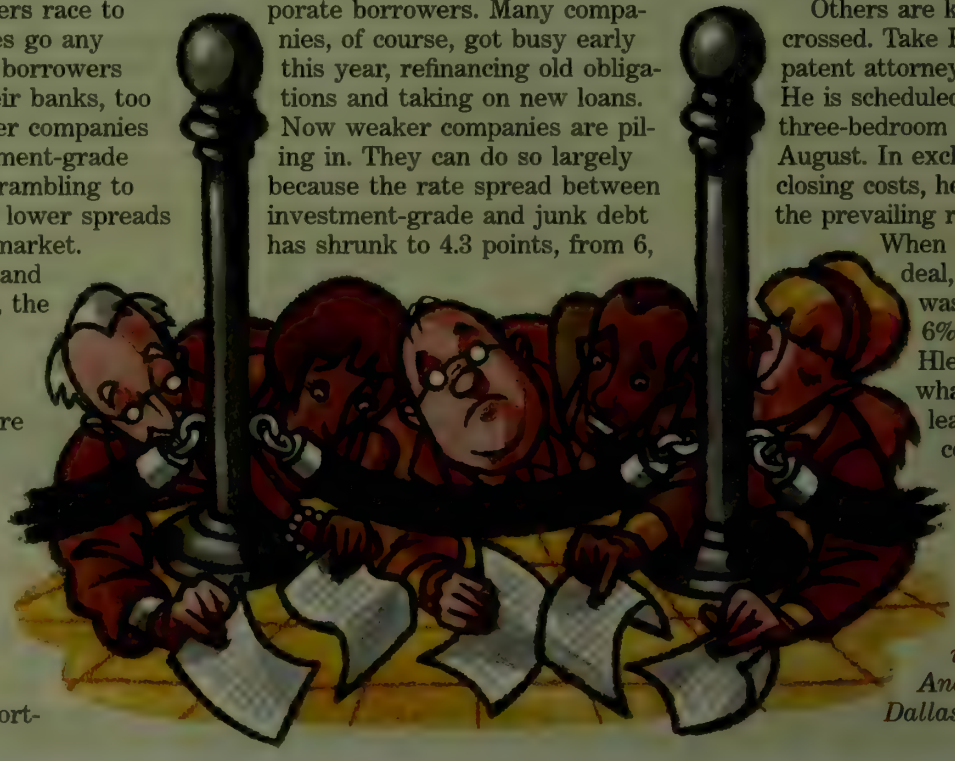
The surge in mortgage applications is stretching many lenders. New loan applications in the week ended July 18 were up 7% from a month earlier and 26% year over year, according to the Mortgage Bankers Assn. The latest two weeks were busier than any other in 2003 except the week ended May 30. At CTX, for example, some employees are logging 16-hour days and working six days a week to keep up with the paperwork—and that's since the company hired 20% more loan officers over the past two years. "We're working frantically," says Jan Weiland, a loan officer at Woodfield Planning Corp. in suburban Chicago.

A similar frenzy has infected corporate borrowers. Many companies, of course, got busy early this year, refinancing old obligations and taking on new loans. Now weaker companies are piling in. They can do so largely because the rate spread between investment-grade and junk debt has shrunk to 4.3 points, from 6, since the beginning of the year, thanks to investors chasing higher returns. Prompted in part by fears that those spreads could widen aga companies issued $71.2 billion in ju bonds in the second quarter, nearly triple the first quarter's $24.1 billio according to Standard & Poor's.

Still, the urge to refinance or iss new debt is not nearly as pronounced as it has been when inter rates shot up before. Even after their recent surge, rates remain at historical lows. Some are even betting that they could decline again i the economy loses momentum, givi them another shot at refinancing o getting that first loan.

Others are keeping their finge crossed. Take Paul Hletko, a patent attorney in Evanston, Ill. He is scheduled to close on a three-bedroom condo in mid-August. In exchange for paying closing costs, he agreed to go wi the prevailing rate on that date. When he first made the deal, the 30-year rate was 5.37%. Today, it' 6%. "I don't like it," Hletko says. "But what can you do?" A least he can take comfort in this: Even at 6.25%, h still be paying le than he would have a year ag

By Michael Arndt in Chica with Stephanie Anderson Forest in Dallas



COMMENTARY

By Rich Miller

WHO NEEDS THE LONG BOND?

hen Treasury Under Secretary Peter R. Fisher abruptly announced in the fall of 2001 at the government would no longer sue 30-year bonds, he argued that the new era of budget surpluses e so-called "long bond" was a relic the past. So, with the federal ficit now projected to hit a record 55 billion this year—and rise even gher in 2004—does at mean it's time to ing back the 30? Probably not. ainly put, it costs e Treasury more ney in interest exnse to issue 30-year nds than it does to rrow via shorterm notes. Judging today's rates, Un- Sam would have to y roughly 5% inter- on 30-year bonds just 4% for 10- ar notes. And with deficit back, the t thing the Treay wants to do is ther add to its borving costs. "Isance of the 30-year is not consist with our objective of the west-cost financing," Fisher says. Nevertheless, there's a growing rus on Wall Street and Capitol l calling for the return of the d. The bond's faithful got a boost July 16 when Federal Reserve airman Alan Greenspan told lawkers that "times have changed" l that the decision to scrap the year needed to be reconsidered. th Fisher, the architect of the demise, leaving the Treasury October, they hope that his successor will repeal his move.

So what's the case for bringing back the long bond? Proponents claim that over time it would lower the government's borrowing costs. After all, the Treasury, like homeowners, could refinance part of its debt at rates near 45-year lows. And by shifting more borrowing from 10-year notes to 30s, Treasury could defuse some of the upward pressure on mortgage rates, which are priced off of 10-year Treasuries.

> "The reissuance of 30-year bonds would be positive in a whole host of ways for financial markets"
>
> **JON S. CORZINE**
> *Senator (D-N.J.)*

> "Issuance of the 30-year is not consistent with our objective of the lowest cost financing"
>
> **PETER R. FISHER**
> *Treasury Under Secretary*

The reintroduction of the 30-year bond also would help Corporate America by allowing companies to use it as a benchmark to issue long-term debt at potentially lower rates. Moreover, pension funds and insurers would use the 30-year bond to better match up their assets with liabilities. "The reissuance of 30-year bonds would be positive in a whole host of ways for financial markets," says Senator Jon S. Corzine (D-N.J.).

Treasury officials aren't convinced and insist that Fisher's departure won't change the department's stance. Yes, it would be great if the Treasury could lock in today's low rates through a one-time issue of 30-year bonds. But that's not possible. The Treasury isn't your ordinary borrower. As the biggest issuer of debt in the U.S., it could wreak havoc in the markets if it tried to time its borrowing to get the lowest rates.

That means that the Treasury can't just issue one or two slugs of 30-year bonds to lock in today's low rates and then withdraw from the long end of the market. If it wants to bring back the 30, it has to commit to issuing a steady stream of them for the foreseeable future, even if rates rise. That means it would keep paying higher rates on 30s than it would on 10s in any given year.

What's more, it's doubtful that the Treasury could ease much upward pressure on mortgage rates by shifting to 30-year bonds. Even proponents admit the impact will be minimal and would be swamped by other factors, such as the inflation outlook.

As for the proponents' belief that reintroducing the long bond would benefit corporate borrowers, they may be right—but why should the government subsidize that? If pension funds and insurers are so eager to buy long bonds to better match their assets with their long-term liabilities, why aren't they snapping up the old ones that are still trading?

There's no doubt that the drumbeat in favor of bringing back the long bond is getting louder. But so far, the arguments have produced more noise than substance.

Miller covers economic policy from Washington.

E TWO SIDES OF THE 30 DEBATE

E PROS:

- ike homeowners, Treasury could refinance long-term ebt at today's low rates. If rates rise, that could ring huge savings.
- ew 30-year notes could lower companies' costs for suing long-term debt and allow insurers and pension nds to better match assets and liabilities.
- hifting borrowing from 10-year notes to 30-year nds could lessen upward pressure on mortgage tes, which are priced off of 10-year notes.

THE CONS:

- Unlike homeowners—who can lock in a mortgage for 30 years—Treasury always needs to borrow. So it still wouldn't be insulated from rising rates.
- Treasury would have to pay higher rates on 30-year bonds than on 10-year notes. Taxpayers shouldn't subsidize the needs of the private sector.
- The higher borrowing costs could push up the federal deficit—putting upward pressure on rates, including those for mortgages.

COMMENTARY

By Stan Crock

IRAQ: AFTER THE SHOOTOUT

It was the kind of break that a beleaguered Bush Administration desperately needed after months of taking heat for its Iraq policy. On July 22, a local tipster led U.S. Special Forces and 101st Airborne Div. troops to the hideout of Saddam Hussein's sons Uday and Qusay. In a fierce firefight, Iraq's No. 2 and No. 3 Most Wanted officials were killed. The shootout in Mosul left Pentagon officials jubilant, sparking renewed hopes that American soldiers might soon track down Saddam Hussein and halt a spreading guerrilla war and the toll it's taking on U.S. troops.

TIME FOR LIGHTER, MORE AGILE FORCES

Removing the threat of a Hussein clan return to power is key to U.S. hopes for rebuilding a shattered Iraqi economy and society. The death of the sons could diminish the opposition's ardor and persuade civilians fearful of Hussein's retaliation to provide intelligence to American forces. The successful Mosul operation may also help convince Iraqis that the coalition will prevail, capturing their minds, if not their hearts. "Winning the minds is the more important," says Andrew F. Krepinevich Jr., executive director of the Center for Strategic & Budgetary Assessments.

Still, the celebrations were tempered by the sobering realization that even if the U.S. military pulls off a "decapitation strategy," it may not put a quick end to the bubbling unrest in Iraq. Postwar Iraq remains a shooting gallery, where foreign soldiers and cooperative Iraqis are tempting targets for various factions, from Baath Party loyalists with a price on their heads to Shiite militants dreaming of a theocratic state. "There will be bumps in the road," Iraq administrator L. Paul Bremer III said in a July 23 speech. "Total security is not possible."

To compound the danger, some members of Saddam's Republican Guards have dispersed into semi-autonomous rebel cells with access to stashes of arms. And their targets could expand to employees of U.S. companies trying to restore normalcy. Says Michael P. Hitchcock, vice-president of London's Control Risks Group: "If this guerrilla war continues, we'll see civilians being targeted."

What this adds up to is a cadre of anti-American insurgents who could make trouble in the future. Their goal, military officials admit, is to make America relive the nightmares of Vietnam, Lebanon, and Somalia and erode U.S. domestic support for the war. "The Arab press says, 'We drove them out of Beirut, we drove them out of Somalia; you know we'll drive them out of Baghdad,'" General John Abizaid, head of the U.S. Central Command, said in a recent briefing. "They're not driving us out of anywhere."

To achieve a different outcome from the earlier fiascoes, experts say Washington needs not only savvy military tactics but also a parallel effort to create a sense of economic and political progress. "People have to have a sense things are getting better," says Michael Eisenstadt, senior fellow at the Washington Institute for Near East Policy. "If we can do that, it will make it much more difficult for the opposition to recruit new members."

What can the U.S. realistically do to contain the Iraqi insurgency? For starters, the Pentagon is thinking about reshuffling the mix of forces it has in the country now. The heavy-armor warfare specialists who took Baghdad are fine for fighting conventional battles but not small bands of out-of-uniform mischief-makers toting rocket-propelled grenades (RPGs). Some heavy tanks, which can withstand RPGs and land mines, will still be needed to protect convoys. But the coalition needs

How to Fight a Guerrilla War

DIFFERENT TROOPS

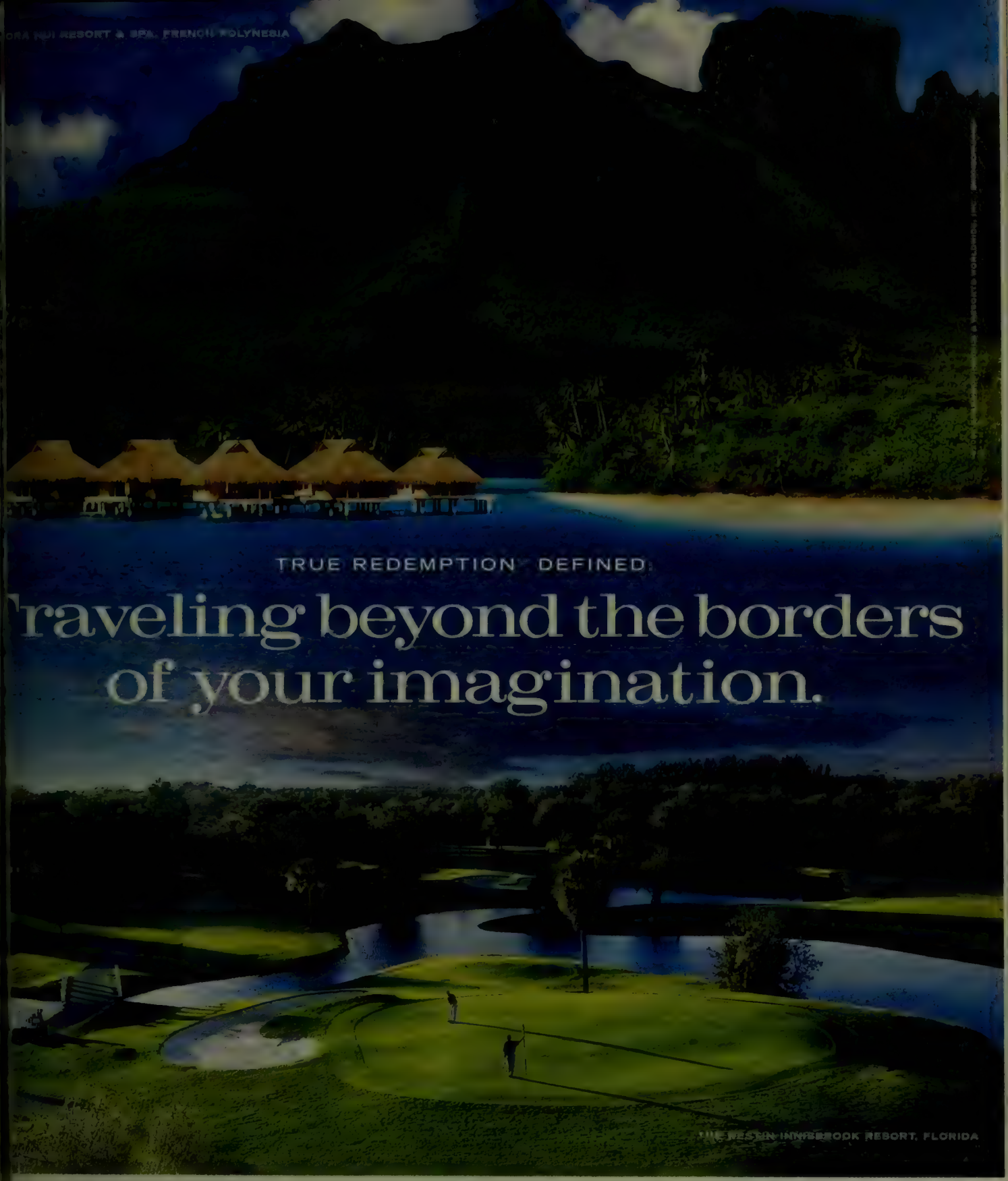
Rather than the heavily mechanized force in Iraq now, the U.S. could rotate in mobile light infantry. These troops are better suited to hit-and-run counterinsurgency and are a less menacing presence.

HEARTS AND MINDS

The deaths of Saddam's sons may help convince locals the occupiers will eventually prevail. Sending in more personnel trained in psychological operations also could help turn Iraqis against the guerrillas.

FOREIGN SOLDIERS

Non-American troops would provide more legitimacy to the occupation. Crucially, it also would reduce G.I.s' exposure and help boost their morale, an issue that the Pentagon is keen to address.



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more light infantry, trained for this kind of combat at the Joint Readiness Training Center at Fort Polk, La. More of them are likely to be deployed as the heavy units are rotated out. "We need different kinds of forces," Abizaid acknowledges.

Some light troops already are in the battle theater. Putting constant pressure on the guerrillas, these infantry units frequently conduct as many as two dozen raids a day and hundreds of patrols, leading to arrests of scores of suspects. U.S. forces often discuss tactics with their British counterparts, who, thanks to service in Northern Ireland, have a lot of experience dealing with counterinsurgencies. The fast operations pace is consistent with British doctrine, which calls for "surprise, tempo, and simultaneity...to overwhelm and unhinge the insurgent," according to an article by retired British Army Brigadier Gavin Bulloch.

A few hundred civil-affairs and psychological operations experts also may be needed. Their role: to convince Iraqis at the village level that Washington is there to help and to elicit critical intelligence to root out guerrilla cells. "I'm not so sure the numbers of people are critical so much as the intelligence capability," says Michael E. O'Hanlon, a defense expert at Washington's Brookings Institution.

In a lesson the British learned in Northern Ireland and Oman, the troops use arrests rather than firefights to avoid TV footage of bloodied Iraqi civilians. "Using the minimum force required" is critical to swaying popular sentiment, says Rosemary Hollis, a Middle East expert at London's Royal Institute of International Affairs.

America's track record in such ventures isn't encouraging. But in Afghanistan and Iraq, U.S. forces demonstrated an ability to adapt. The Mosul operation shows intelligence is improving. And September 11 produced a steely resolve in the Bush Administration. This is one guerrilla campaign the U.S. can't afford to lose.

With Kerry Capell in London, Stephanie Anderson Forest in Dallas, and bureau reports

ILLUSTRATION BY PHIL FOSTER

PROFITS

ALL'S WELL THAT ENDS WELL

The odds were against solid quarterly profits—and yet...

With the U.S. at war in Iraq, oil prices rising, and the SARS epidemic threatening to shut down the supply chain out of Asia, the deck seemed stacked against a stellar second quarter for corporate earnings. But as the quarter fades into memory, it looks as though many companies played a tough hand well. Thanks to a favorable swing in the dollar and further steps by companies to cut costs and boost productivity, Corporate America kept the earnings recovery on track.

Even after allowing for the weaker profit reports expected in coming weeks from utilities, the consensus among Wall Street analysts is for a 6.7% rise in second-quarter operating income for the companies in the Standard & Poor's 500-stock index, according to Thomson First Call. That is nearly a full point higher than forecasts in early June. And *BusinessWeek*'s flash report from 120 early-filing companies shows that income from continuing operations, after excluding special charges, was up 18% compared with the previous year.

With business demand still weak, however—revenues for the 120 companies in the *BusinessWeek* survey rose only 3%—most businesses earned their profits through aggressive cost-cutting. But that should give companies even more leverage if the economy surges this fall as forecast. Analysts polled by Thomson First Call now expect profits for companies in the S&P 500 to climb 13.6% in the third quarter and 21.5% in the fourth quarter. Having already dealt with SARS and war, Corporate America has beat the odds before.

By Brian Grow in Ocala, Fla.

	CURRENT QTR (MILLS
INDUSTRIALS	310,71
ABBOTT LABORATORIES	4,72
AK STEEL HOLDING	1,02
ALCOA	5,46
ALTRIA GROUP	15,48
AMERICAN STANDARD	2,26
ASHLAND ††	2,02
BAXTER INTERNATIONAL	2,16
BOEING	12,78
BOISE CASCADE	1,92
CATERPILLAR	5,93
CENTEX †	2,31
COCA-COLA	5,69
COCA-COLA ENTERPRISES	4,61
COLGATE-PALMOLIVE	2,45
CONAGRA FOODS †††	3,90
CROWN HOLDINGS	1,72
DELPHI	7,09
EASTMAN KODAK	3,35
FORD MOTOR	40,80
GENERAL DYNAMICS	3,93
GENERAL ELECTRIC	33,22
GENERAL MILLS †††	2,54
GENERAL MOTORS	48,30
GEORGIA-PACIFIC	5,04
HARLEY-DAVIDSON	1,29
HONEYWELL INTERNATIONAL	5,74
ILLINOIS TOOL WORKS	2,56
INGERSOLL-RAND	2,52
JOHNSON & JOHNSON	10,33
JOHNSON CONTROLS ††	5,95
KRAFT FOODS	7,84
MAYTAG	1,16
MERCK	13,28
NIKE †††	2,98
OCCIDENTAL PETROLEUM	2,26
PEPSI BOTTLING GROUP	2,53
PEPSICO	6,53
PRAXAIR	1,40
SCHERING-PLOUGH	2,33
SCHLUMBERGER	3,55
TEXTRON	2,59
3M	4,56
UNITED TECHNOLOGIES	7,79
VISTEON	4,61
SERVICES	183,28
ALLSTATE	7,89
AMAZON.COM	1,09
AMR	4,32
AOL TIME WARNER	10,81
BANK OF AMERICA	
BANK ONE	
BEST BUY †	4,66
BURLINGTON NORTHERN SANTA FE	2,29
CAPITAL ONE FINANCIAL	2,38
CENDANT	4,58
CITIGROUP	23,84
CNF	1,23
COSTCO WHOLESALE ††	9,54
COUNTRYWIDE FINANCIAL	
DARDEN RESTAURANTS †††	1,22
DELTA AIR LINES	3,30
DOW JONES	39
FEDEX †††	5,83

% CHG.	EST. EPS (5/15/03)	REPORTED EPS	DIFF.
-13	0.55	0.50	-0.05
-58	0.52	0.16	-0.36
NM	-0.41	-0.72	-0.31
-4	0.26	0.27	+0.01
-7	1.17	1.20	+0.03
-1	1.84	1.83	-0.01
+16	1.61	1.03	-0.58
-75	0.41	0.08	-0.33
NM	0.47	-0.24	-0.71
NM	-0.23	-0.12	+0.11
100	0.64	1.15	+0.51
+63	1.80	2.22	+0.42
+11	0.54	0.55	+0.01
+21	0.54	0.56	+0.02
+10	0.62	0.62	—
-25	0.41	0.42	+0.01
+13	0.26	0.43	+0.17
-60	0.31	0.16	-0.15
-61	0.67	0.39	-0.28
-31	0.14	0.22	+0.08
-11	1.18	1.22	+0.04
-14	0.38	0.38	—
295	0.63	0.59	-0.04
-30	1.22	1.58	+0.36
NM	0.17	0.25	+0.08
-40	0.58	0.66	+0.08
-31	0.37	0.37	—
+7	0.88	0.92	+0.04
68	0.72	0.89	+0.17
27	0.69	0.40	-0.29
+8	1.87	2.00	+0.13
+5	0.58	0.55	-0.03
63	0.56	0.32	-0.24
+7	0.84	0.83	-0.01
18	0.91	0.92	+0.01
55	0.89	0.97	+0.08
-6	0.49	0.47	-0.02
15	0.58	0.58	—
0	0.87	0.92	+0.05
71	0.19	0.12	-0.07
25	0.31	0.24	-0.07
-40	0.65	0.46	-0.19
33	1.50	1.56	+0.06
+1	1.24	1.26	+0.02
NM	-0.03	-1.33	-1.30
35	0.58	0.70	+0.12
71	0.79	0.84	+0.05
NM	0.06	-0.11	-0.17
NM	-3.82	-0.47	+3.35
70	0.10	0.23	+0.13
23	1.53	1.80	+0.27
+2	0.73	0.75	+0.02
13	0.17	0.21	+0.04
+3	0.52	0.54	+0.02
35	1.10	1.23	+0.13
60	0.35	0.37	+0.02
12	0.79	0.83	+0.04
16	0.45	0.31	-0.14
18	0.31	0.33	+0.02
01	2.70	2.74	+0.04
16	0.34	0.35	+0.01
M	-2.25	1.40	+3.65
3	0.21	0.38	+0.17
19	0.89	0.92	+0.03

	CURRENT QTR. SALES (MILLIONS)	% CHG.	QTR. PROFITS (MILLIONS)	% CHG.	EST. EPS (5/15/03)	REPORTED EPS	DIFF.
FLEETBOSTON FINANCIAL	NA	NA	571.0	NM	0.57	0.54	-0.03
GANNETT	1,705.3	+6	324.3	+7	1.21	1.20	-0.01
GOLDMAN SACHS GROUP	5,985.0	-4	695.0	+23	1.08	1.36	+0.28
GRAINGER (W.W.)	1,172.7	-2	56.0	+3	0.63	0.60	-0.03
HCA	5,467.0	+12	240.0	-31	0.78	0.47	-0.31
IMS HEALTH	337.8	+11	55.4	+3	0.24	0.23	-0.01
J.P. MORGAN CHASE	NA	NA	1,827.0	+78	0.54	0.89	+0.35
KELLY SERVICES	1,059.5	+4	1.5	-62	0.05	0.04	-0.01
LEHMAN BROTHERS HOLDINGS	4,470.0	+3	437.0	+48	1.06	1.67	+0.61
MANPOWER	3,013.4	+16	29.1	+13	0.34	0.37	+0.03
MERRILL LYNCH	7,295.0	-1	1,021.0	+61	0.66	1.05	+0.39
MORGAN STANLEY	8,418.0	+3	599.0	-25	0.68	0.55	-0.13
NATIONAL CITY	NA	NA	617.0	+57	0.72	0.99	+0.27
NEW YORK TIMES	801.9	+4	72.8	-8	0.54	0.47	-0.07
NORFOLK SOUTHERN	1,633.0	+3	137.0	+15	0.38	0.35	-0.03
NORTHWEST AIRLINES	2,297.0	-5	227.0	NM	-2.98	2.45	+5.43
PROGRESSIVE	2,918.7	+29	286.3	+78	1.03	1.29	+0.26
ROADWAY	741.5	+13	6.6	+43	0.73	0.35	-0.38
SEARS, ROEBUCK	10,196.0	+1	309.0	+35	0.94	1.04	+0.10
SOUTHWEST AIRLINES	1,515.0	+3	246.0	+141	0.09	0.30	+0.21
SUNTRUST BANKS	NA	NA	330.4	-4	1.18	1.17	-0.01
SUPERVALU †	5,836.3	+3	73.7	-5	0.55	0.55	—
TRAVELERS PROPERTY CASUALTY	3,748.7	+13	441.2	+33	0.43	0.44	+0.01
U.S. BANCORP	NA	NA	953.6	+16	0.49	0.49	—
UNITED PARCEL SERVICE	8,226.0	+7	692.0	+13	0.59	0.61	+0.02
UNITEDHEALTH GROUP	7,087.0	+17	439.0	+35	0.66	0.71	+0.05
WALGREEN ††	8,328.0	+13	296.1	+14	0.29	0.29	—
WASHINGTON MUTUAL	NA	NA	1,020.0	+3	1.09	1.10	+0.01
WELLPOINT HEALTH NETWORKS	4,940.4	+15	224.5	+35	1.38	1.49	+0.11
WELLS FARGO	NA	NA	1,525.0	+7	0.90	0.90	—
YELLOW	713.5	+10	18.4	+599	0.56	0.62	+0.06
YUM! BRANDS	1,936.0	+10	122.0	-13	0.46	0.40	-0.06
TECHNOLOGY	**70,773.0**	**+5**	**3,317.2**	**NM**	**0.16**	**0.07**	**-0.09**
ADVANCED MICRO DEVICES	645.3	+7	-140.1	NM	-0.26	-0.40	-0.14
AMGEN	2,041.1	+63	607.2	+47	0.45	0.45	—
APPLE COMPUTER ††	1,545.0	+8	19.0	-41	0.03	0.05	+0.02
EMC	1,479.3	+7	81.7	NM	0.03	0.04	+0.01
FIRST DATA	2,114.2	+12	353.8	+18	0.47	0.47	—
GENENTECH	799.7	+29	132.3	NM	0.26	0.25	-0.01
IBM	21,631.0	+10	1,725.0	+288	0.98	0.98	—
INTEL	6,816.0	+8	896.0	+101	0.13	0.14	+0.01
JABIL CIRCUIT ††	1,219.3	+43	4.5	-79	0.18	0.02	-0.16
LEXMARK INTERNATIONAL	1,120.2	+6	101.7	+14	0.78	0.77	-0.01
LUCENT TECHNOLOGIES ††	1,965.0	-33	-254.0	NM	-0.05	-0.07	-0.02
MICRON TECHNOLOGY ††	732.7	-5	-214.9	NM	-0.51	-0.36	+0.15
MICROSOFT †††	8,065.0	+11	1,921.0	+26	0.24	0.18	-0.06
MOTOROLA	6,163.0	-10	119.0	NM	0.04	0.05	+0.01
ORACLE †††	2,832.0	+2	858.0	+31	0.14	0.16	+0.02
PEOPLESOFT	497.4	+3	36.5	+1	0.12	0.11	-0.01
SANMINA-SCI ††	2,648.9	+1	-12.2	NM	0.01	-0.02	-0.03
SOLECTRON ††	2,815.5	-7	-3,101.2	NM	-0.03	-3.74	-3.71
SUN MICROSYSTEMS †††	2,982.0	-13	12.0	-80	0.02	0.00	-0.02
TEXAS INSTRUMENTS	2,339.0	+8	121.0	+27	0.08	0.07	-0.01
YAHOO!	321.4	+42	50.8	+138	0.08	0.08	—
UTILITIES & TELECOM	**14,434.5**	**+9**	**1,597.3**	**+102**	**0.43**	**0.45**	**+0.02**
BELLSOUTH	5,642.0	-2	951.0	+262	0.49	0.51	+0.02
CONSOLIDATED EDISON	2,175.0	+18	69.0	-32	0.42	0.29	-0.13
DOMINION RESOURCES	2,604.0	+12	240.0	-12	0.88	0.76	-0.12
NEXTEL COMMUNICATIONS	2,556.0	+19	309.0	+151	0.23	0.27	+0.04
NORTHEAST UTILITIES	1,457.5	+28	28.3	-7	0.05	0.21	+0.16

† First-quarter results †† Third-quarter results ††† Fourth-quarter results NM = not meaningful NA = not available

Data: Standard & Poor's COMPUSTAT

Earnings estimate data provided by Thomson Financial/First Call

EARNINGS

FOR GM, MORTGAGES ARE THE MOTOR

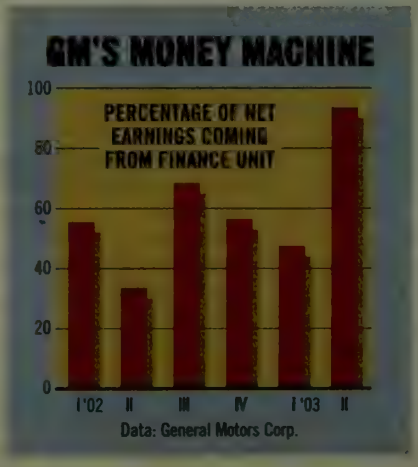
But how long can it rely on profits from its finance unit?

Given the weak profits in the auto business these days, General Motors Corp.'s second-quarter earnings didn't look too bad. GM weathered a weak economy, falling car sales, and a vicious price war to salvage a $901 million profit. The results, announced on July 17, beat Wall Street expectations. Company Vice-Chairman and Chief Financial Officer John M. Devine said GM may be able to hit this year's profit target of $2.9 billion, a goal that management had become less and less optimistic about in recent months.

But hang on a second: GM isn't making all that money selling cars. In fact, the auto maker's all-important North American vehicle operation made a paltry $83 million, down from $1.3 billion a year earlier. So where did the other $818 million in second-quarter profits come from? Try General Motors Acceptance Corp., GM's lending arm. And it's not primarily car loans that helped GM bring home the bacon. Half of those finance profits came from GMAC's mortgage business, including its fast-growing Ditech.com online mortgage subsidiary. These days, GM looks a lot more like a financial institution that happens to sell cars and trucks than a successful auto maker.

GM's reliance on mortgage lending to drive profits could come back to bite. Interest rates have risen almost half a percentage point since mid-June—and some economists say the refi boom that has sustained so many mortgage companies could run out of gas by fall. Even GMAC Chairman and President Eric A. Feldstein says the finance unit cannot keep up its current lending pace. At the same time, GMAC is shopping around its highly profitable commercial mortgage business. Add it all up, says Morgan Stanley analyst Stephen Girsky, and GM's second-half finance profits could fall one-third, to $950 million. "At some point, the auto business has to start carrying the ball."

Don't count on that happening anytime soon. By the end of June, GM's inventories were running 21% above normal. To address the overcapacity, the auto maker will cut production by 6% for the third quarter. CFO Devine says he is optimistic that the economy will begin to rebound in the second half, but he doesn't see profit-eating incentives going away. As a result, Girsky predicts GM's auto business will lose $150 million in the third quarter. "It's a



"At some point, the auto business has to start carryin the ball"

hope that we can scale back tives," Devine says. "But we build business plans on hope."

Making things worse, GM's we tomotive profits are hurting its unit margins. Standard & Poor's graded GM to BBB last year, an rating was affirmed with a ne outlook in April due to eroding gins, fat sales incentives on its car cash obligations to its union re Since downgrades raise borrowing and GMAC must borrow billions to funding loans, last year's downgr BBB cost GMAC $200 million in pr

Moreover, GM is selling its co cial mortgage unit because its borr rates make it too difficult to get su capital and low enough rates to e A sale, which could bring up to $1 lion, also would help GM bolster it sion fund. But the commercial mor business accounted for roughly $10 lion of GMAC's $417 million in mor profits in the second quarter. D times when demand slackens for dential mortgage refinancing, the mercial mortgage business accoun an even bigger portion of GMAC pr

Certainly, the outlook will even improve for the auto business. In and 2005, GM will be replacing as as 22% of its sales volume with cars and trucks, much faster than Motor Co. and even Toyota Motor If it can avoid deep incentives, the vehicles could help lift profits next says Prudential Financial Inc. ar Michael Bruynesteyn.

Until then, GM will struggle remain depende its finance arm. question, says Deu Bank Securities analyst Rod Lac whether GM can around its auto ness in time to the decline in finance unit. If GM could face times once GMA no longer min money.

By David Wel Detroit

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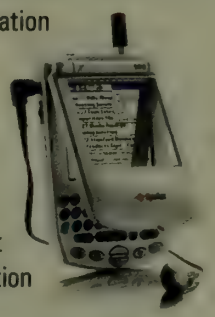

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In Business This Week

EDITED BY ANNE NEWMAN

ABBOTT'S MEA CULPA

ABBOTT LABS HAS GIVEN ITself another black eye. On July 22, the North Chicago drug and medical-products giant pleaded guilty to a felony count of obstruction of justice stemming from a federal probe into whether Abbott had bilked the government's Medicare and Medicaid programs. As part of the plea, Abbott agreed to pay $600 million in criminal and civil fines. Prosecutors allege that the FBI, which set up a dummy company, caught Abbott sales reps on videotape telling purchasers how to bill the government at full prices for free or discounted nutritional liquids. Two years ago, an Abbott joint venture paid $875 million in fines because of a similar scheme involving a prostate-cancer drug, Lupron. And in 2000, Abbott settled Federal Trade Commission charges that it had paid a rival drugmaker to keep a generic product off the market.

IS UPS DELIVERING A RECOVERY?

IS THE SPUTTERING U.S. economy finally gaining some momentum? It just may be, judging by the second-quarter earnings that bellwether United Parcel Service released on July 22. The Atlanta-based shipper's daily domestic volume of packages grew for the first time in more than two years, rising 1.2%, to 11.8 million parcels. That growth helped boost Big Brown's earnings 13% in the quarter, to $692 million. UPS expects to build on the volume gains, with 2% to 3% growth expected in upcoming quarters. Still, company executives cautioned against reading too much into the numbers. For now, they see little sign that shipments of raw materials and finished goods—crucial signs that a recovery is fully under way—are picking up much speed.

MORE DETAIL ON MUTUAL-FUND SALES

FOR INDIVIDUAL INVESTORS, "What'd you pay for that mutual fund?" has ranked as the hardest question to answer. That may change in the wake of a July 22 Wall Street task force report aimed at getting brokerage firms to do a better job of cutting sales loads for investors whose mutual funds qualify for discounts. Among other recommendations, the NASD-headed panel asks the Securities & Exchange Commission to consider requiring brokerages to include the full percentage sales commission on confirmation statements they send to investors who buy mutual funds that charge loads. That would let investors verify that the correct charge was applied.

CLOSING BELL

CHARMED

Pottermania lifted second-quarter sales at Amazon.com 37%, to $1.1 billion, while cost-cutting kept losses to $43 million, vs. $94 million the year before. The e-tailer sold 1.4 million copies of the new Harry Potter book in June, and free shipping fired up sales. The stock rose 15%, to $40.11, up 105% for the year.

Data: Bloomberg Financial Markets

HEADLINER: SCOTT McNEALY

SOLAR ECLIPSE

Sun Microsystems is in a deep rut. While rivals like Dell and IBM are reporting healthy earnings, the Santa Clara (Calif.) maker of servers is fighting to eke out a profit. For Sun's fourth fiscal quarter ended June 30, net profit plunged 80%, to $12 million, down from $61 million a year earlier. Revenue fell 12.9%, to $2.98 billion. For the fiscal year, Sun had sales of $11.4 billion, down 8.5%, and lost $2.38 billion, including noncash expenses of $2.13 billion.

CEO Scott McNealy admits Sun is struggling. "We're dealing with a pretty tough year," he said in a July 22 conference call. A lysts say Sun's proprieta servers are being hit by low-cost competition fr servers running on tel-made chips a Windows or Lir software. Whil Sun now sells called "Lintel" servers, it's pl ing catch-up. Moreover, its breakeven point higher than rivals' cause of heavy R&D cost While Sun's gross ma gins hit 43.7%, 2.4 points higher than the year bef the gains aren't likely to last in the face of rivals' gressive pricing. Investo sent Sun shares down 19.3%, to $3.85, on July

Jim Kerst

KODAK FILLS A CAVITY

AS ITS CONSUMER BUSINESS gets hammered, Eastman Kodak is trying to build its imaging business. While its July 21 move to buy PracticeWorks makes strategic sense, this won't make up for declining film sales. PracticeWorks, which makes digital X-ray gear for dentists, is expected to add $215 million to Kodak's annual sales of $13 billion, but the deal will hurt earnings through 2005. Meanwhile, Kodak continues to trim at its consumer division: On July 23, it said it would cut 4,500 to 6,000 jobs, or 9% of its workforce.

CONVERGENCE COMES TO YOUR BILL

LOCAL PHONE COMPANIES SBC Communications and Qwest took big strides in their race with cable operators to offer a bundle of phone, Int and video service. On Ju SBC unveiled a $500 m convertible-bond invest in satellite-TV player Ech operator of DISH networ early 2004, SBC will offer branded service, making first phone company to bine local and long dis with cellular, Internet, video under one bill. Qw teaming up with EchoSt a more limited basis. deals send notice to cabl erators that their phone are revving up the battle consumer loyalty.

ET CETERA...

- Walt Disney hired in ment bankers to sell its ey-losing 580-store chain
- Credit Suisse First B former Vice-Chairman Je Peek was named CIT pres
- ImClone Systems founder Harlan Waksa signed on July 21.

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EDITED BY RICHARD S. DUNHAM

A GRASS-ROOTS REVOLT AGAINST INFORMATION-AGE INTRUDERS

Even the politically conscious crew in the West Wing had no idea how raw a nerve they would touch when President Bush on June 28 announced the creation of a Do Not Call Registry to protect Americans from unwanted telemarketing. In the first three weeks after the Federal Trade Commission opened the no-call list on July 1, more than 27 million Americans signed up. It's just the latest sign of a growing grassroots backlash against intrusive information purveyors of the New Economy. And politicians across the ideological spectrum are jumping on the bandwagon of technopopulism.

They cast themselves as the defenders of ordinary voters who want to rein in spammers jamming e-mail systems, telemarketers interrupting ever-vanishing family time, and credit companies trading in consumer financial data. "Americans have accepted technology as a piece of their everyday lives, but they're still fighting it," explains Representative Richard M. Burr (R-N.C.), co-sponsor of one of the rapidly proliferating anti-spam bills on Capitol Hill.

ANTI-SPAMMER: *Burr*

The movement to block Information Age aggravations is creating strange bedfellows. Conservatives, traditionally focused on Big Government intrusions on individual privacy, are considering joining liberals in the fight against corporate nosiness. "There's so much information available to so many people that you have to rethink how to build the walls," says David A. Keene, chairman of the American Conservative Union.

Buoyed by the popularity of the Do Not Call Registry, a broad Left-Right coalition—uniting the Consumers Union with the U.S. Chamber of Commerce—wants an anti-spam bill next. The legislation faces hurdles in the House, where members are squabbling over whether to give consumers the right to sue spammers. But public outcry is pressuring lawma reach a deal this year. While liberals are out to prote sumers from shady operators and commercialization run corporate interests want to ensure the survival of the ing Internet marketplace. "Spam is making consume likely to purchase online," says Joe Rubin, executive d for technology and e-commerce at the Chamber of Com

A Senate bill by conservative Conrad Burns (R-Mon liberal Ron Wyden (D-Ore.) to combat b solicited e-mail is moving quickly. It wo quire e-mail marketers to give consume ability to opt out of receiving such me and impose penalties of up to $3 million fenders. Because of rising public anger at control spammers, support for the bil achieved critical mass," Burns says.

But concerns about privacy extend b the e-mail inbox. Senate Banking Com Chairman Richard C. Shelby (R-Ala.) is p ing a new push for tighter curbs on finan stitutions' ability to share customer dat affiliates or outside companies. And House panel on July 16 adopted a pr pushed by Treasury Secretary John W. S combat identity theft, including free credit reports for consumers. The prop coupled with a measure sought by banki terests: permanent renewal of provisions that bar state imposing tougher credit-reporting restrictions than the

Just as Teddy Roosevelt wrestled to protect worke smaller competitors from corporate oligarchs of the Ind Age, today's technopopulists are trying to write new ru the Information Age. Progress may be slow and obs large, but their momentum appears unstoppable.

By Catherine Yang, with Lorraine Woellert and Amy

CAPITAL WRAPUP

THE FCC: LEFT JAB, RIGHT HOOK

▶ Federal Communications Commission Chairman Michael K. Powell has earned the dubious distinction of being the only federal regulator who is too conservative for the Republican Congress. By championing new FCC rules allowing greater concentration of media ownership, free-marketeer Powell has created a political tempest that puts both President Bush and the House GOP leadership in a no-win situation.

On July 23, House leaders yielded to a populist backlash by leaving unchallenged a spending provision to rein in Powell's FCC. The measure would bar the FCC from implementing its new rule allowing TV networks to own local stations covering up to 45% of the national audience. The FCC's decision to expand the ownership cap from its 35% standard provoked a Left-Right political reaction that united such disparate groups as the NRA and NOW. "The ability of big media companies to harm political opponents by characterizing them in scandalous ways is frightening," says NRA CEO Wayne LaPierre Jr.

So far, Powell's plan to allow cross-ownership of TV and newspapers in the same market will go forward. But unless top House Republicans can engineer a win for Powell in the House-Senate conference committee, prospects for 45% rule appear dim. Senate leader including Appropriations Committe Chairman Ted Stevens (R-Alaska), pose the 45% cap. But Powell won't down without a fight. He says the ceiling would mean sales of no more 0.5% of stations. "Our democracy is strong," he says in a July 23 staten "It is not threatened by half a perc

All of this puts the President on hot seat. To protect Powell's prerog tives, the White House is threatenin veto. That could anger Bush's base. Speculation abounds that Powell wil leave the FCC in coming months.

By Catherine

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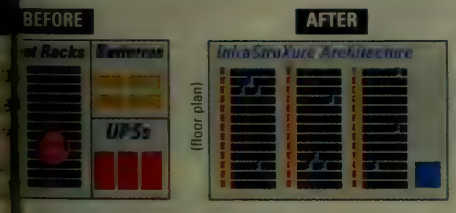

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RUSSIA

THE ENIGMA OF RUSSIA

The economy is booming. But is the country really changing?

By Paul Starobin

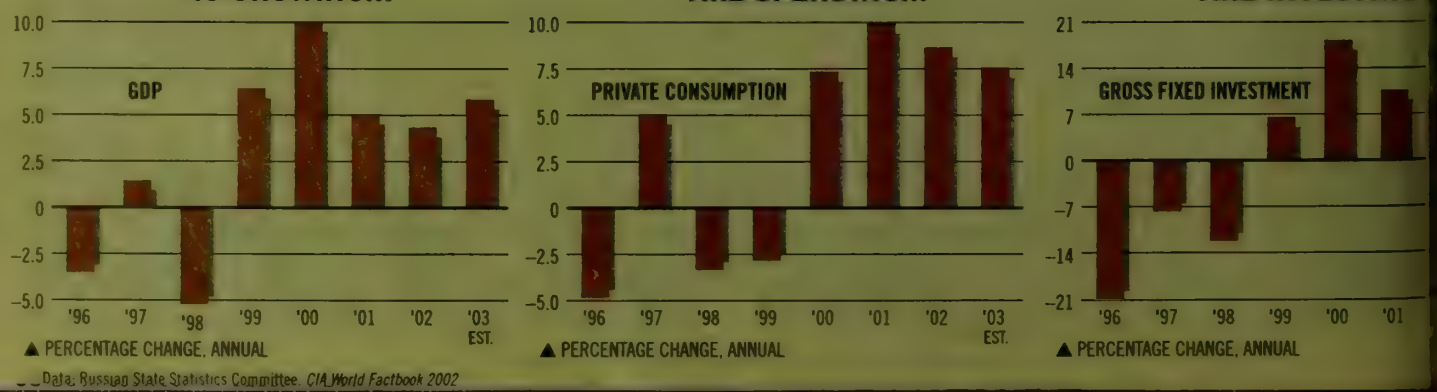
It seems Boris Berezovsky was right. The mercurial, trouble-prone Russian oligarch, who fled Moscow for London in the fall of 2000 to avoid arrest on theft charges, last summer invited me to fly over for lunch at his regular Savile Row haunt. As his bodyguards discreetly ate their lamb chops at a nearby table, Berezovsky explained why his nemesis, the get-tough regime of Russian President Vladimir V. Putin, was such bad news. In Russia, he warned, there is no such thing as a golden mean. Everything is taken to an extreme. "There are no internal limits," he pronounced. No brakes.

At the time, I discounted his warning—which seemed both self-serving and, well, extreme. After all, Russia seemed to be on the rebound after Putin took over for a sclerotic Boris N. Yeltsin on New Year's Day, 2000. The economy was rapidly expanding after tanking in the August, 1998, financial crisis. Polls showed ordinary Russians to be more hopeful than ever. And my favorite optimism indicator, the birthrate, which had fallen off sharply in the dark 1990s, was inching up again. Finally, it seemed, Mother Russia was back on her feet, pushing around baby strollers.

But as my four-year tour as Moscow bureau chief for *BusinessWeek* comes to a close, Berezovsky is looking alarmingly prescient. In a balance-sheet reckoning of a place I love, my head isn't buying what my heart wants to sell. The Yeltsin era, which began brightly, with historic reforms to free Russia from Soviet controls on property and the media but descended into a chaotic sinkhole of corruption, surely was in need of a corrective. But the control-oriented Putin regime is failing to get the balance right. Yeltsin's flawed but genuine liberal impulse is being supplanted by a gathering authoritarian push as the ex-KGB agents and other law-enforcement

ILLUSTRATION CONCEPT BY VLADIMIR; PHOTO COMPOSITION BY RICHARD MICHIEL/BW; PHOTOGRAPH BY JEREMY NICHOLL/POLARIS; CHARTS BY ERIC HOFFMANN/BW

The Good News



Data: Russian State Statistics Committee, *CIA World Factbook 2002*

The crackdown on oligarch Khodorkovsky has deeply alarmed business and foreign investors

ls Putin has worked with for most career—the *siloviki*, or "men of r"—become more confident of their n the Kremlin and key ministries. e *siloviki* have taken increasingly n steps over the last few months to e that they keep their power. Russia ring up for parliamentary elections cember and presidential elections in . If Putin goes, they go, too. So the *i* seem determined to quash poten- position—if necessary, by threat- the property of those deemed ene- In June, the Kremlin press stry pulled the plug on the last pri- ly owned national TV network, re- ing it with a sports channel.

hen, in early July, in a move that rocked Russia Inc. and foreign stors, the country's richest man, aron Mikhail Khodorkovsky, sud- y found his business empire under e. His main partner was arrested letained on property theft charges d to a fertilizer company privati- in 1994 and the prosecutors d investigations into the murders iness and political figures with Khodorkovsky's oil company, , clashed in the late 1990s. The for this legal barrage, it appears, hodorkovsky's stated intention to ll pro-Western liberal parties the camp views as a threat to its plan minate the next Parliament with emlin factions.

n & Co. deny a political motiva- Putin aide says that the particu- kos-related legal cases are being ndently pursued by the federal tor's office with Putin himself be- pt informed of developments but not acting as "the trigger" for the actions. The aide denies the moves were timed to elections—but does portray them as part of Putin's top-priority effort to protect Russian society by building a strong state. "In general, the President is demanding more active work of the *siloviki* in order to ensure that the laws of this country are obeyed," the aide says. "In the last decade, during the 1990s, there was chaos, and the *siloviki* were not doing their job properly." The aide also suggested that Yukos had failed to pay sufficient taxes over the past five years, a charge that a Yukos spokesman hotly denied.

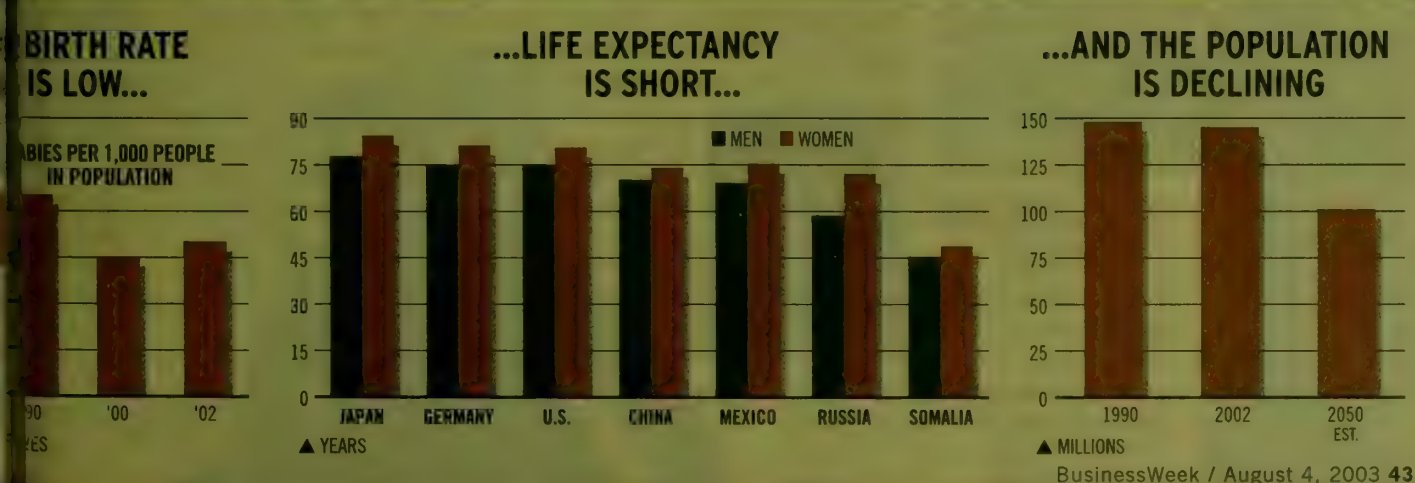
Surely, Khodorkovsky is no angel, but what investors find so worrisome—the Russian stock market has plummeted 15% since the arrest on July 2 of Khodorkovsky's partner, Platon Lebedev—is the apparent political manipulation of the judicial process. Without secure property rights protected by independent courts, Russia's market economy faces a bleak future. "If you look at what Putin says he wants to achieve—a doubling of gross domestic product and a sizable place in the world economy—you're not going to get there by behaving like this," says Stephen O'Sullivan, co-head of research at Moscow investment bank United Financial Group.

As Lebedev sits in the same prison, Lefortovo, where the KGB once detained political prisoners such as Natan Sharansky, Khodorkovsky, just back from a trip to Washington, is frantically bidding for support from the Bush Administration. His company, Yukos, has won praise from Western politicians and investors for its ahead-of-the-pack efforts to improve corporate governance and for Khodorkovsky's advocacy of a close U.S.-Russia strategic partnership built on the flow of Russian oil to the U.S. But the Bush Administration seems reluctant to risk Putin's ire by intervening.

In an hour-long interview at his Yukos headquarters in Moscow on July 21, I found a relaxed Khodorkovsky, clad in a dark-grey polo shirt, closely inspecting a small desk clock sent to him as a gift by the Russian state-owned daily *Rossiiskaya Gazeta*. Just checking for hidden microphones, he joked. Then he got serious. "What we've got in this case is an excess of enthusiasm" on the part of hard-liners in the law-enforcement establishment, he says. "They don't like Big Business and especially independent Big Business—and they feel it's their job to put it in its place." He's resting his hopes for an end to the siege on a meeting with Putin himself. "The only place I can go to complain is the President," Khodorkovsky says. The stakes, in his view, are high. "If we continue hounding rich people and kicking them out of the country," he says, "we will not move far from our primordial cave."

Putin supporters view the legal case being mounted against Khodorkovsky's empire as part of a necessary and continuing campaign to purge Russia of robber-baron capitalism and create more favorable conditions for steady growth. "Putin is making a decision to encourage honest capitalism," Valeri N. Velichko, a 25-year veteran of the KGB and a consultant to its successor, the Federal Security Service (FSB), told me in an interview at his Moscow quarters, from

The Bad News



which he runs a club of ex-KGB officials. He predicts more such actions aimed at oligarchs who control strategic natural resources. "Of course" Putin is behind this campaign, Velichko adds. "Putin is not a half-drunk Yeltsin, and he is not a person here for a short time. He is interested in long-term projects to restore Russia." At the end of the interview, Velichko presented me with a gift calendar displaying portraits of his hero, Felix Dzerzhinsky, the founder of the Soviet secret police.

It is still not clear how far this authoritarian swing-back will go. But Russian history shows that these periods of reaction can be harsh and tend to last a long time—much longer than the liberal reforms that periodically break out (table). In this case, Team Putin is ending a relatively long Russian spring that began before Yeltsin, in the *perestroika* and *glasnost* reforms launched by Mikhail Gorbachev in the mid-1980s.

To be sure, Putin's team has much to be proud of. Five years after the Aug. 17, 1998, ruble crash, the economy has rebounded briskly. GDP is expected to grow 5.8% this year, vs. 2.3% in the U.S. and 0.7% in Europe. The ruble is strong, foreign exchange reserves are a robust $68 billion, and the trade surplus is swelling. Violent, Yeltsin-era clashes between the Kremlin and Parliament are a fading memory. "To have political and economic stability is a very good thing," says Alexander M. Branis, director of Moscow-based investment fund Prosperity Capital Management Ltd. He cites as helpful such Putin reforms as the launch of a flat income tax.

UNDER FIRE
Are Khodorkovsky's liberal politics the real target?

But the progress achieved by the Putin regime threatens to be undone by the *siloviki*. An outright renationalization of assets seems unlikely, as the Putin team knows oligarchs tend to manage large business organizations more efficiently than the state can. But it's possible that "enemy" oligarchs could be pressured to sell their assets to politically acquiescent ones with tight ties to the *siloviki*. "This is the redistribution of property by one clan, using law-enforcement agencies," says the liberal member of Parliament Irina Khakamada.

On one level, the country seems to be lapsing into pre-Revolutionary times, when private business proceeded at the sufferance of the Kremlin [illegible] forts to build a strong st[illegible] guard against anarchy beca[illegible] consuming and destructiv[illegible] tures in their own right.

How did post-Soviet [illegible] get to this point? It's a [illegible] cated tale, about not ju[illegible] Putin clan and its ambitio[illegible] also a traumatized society[illegible] for a paternalistic figure. [illegible] ordinary Russians, after an[illegible] euphoria over the collapse [illegible] Soviet regime, came to see [illegible] selves as not free but aban[illegible] Many viewed the last [illegible] leader, Gorbachev, as a t[illegible] and many turned on Yelt[illegible] weak and feckless because he per[illegible] a new group of predatory wolve[illegible] oligarchs, to rob Mother Russia by[illegible] ing off with her oil fields, gold [illegible] and other wealth in rigged privati[illegible] auctions. Russians' main desire w[illegible] democracy but order.

In this context, Putin, the slim [illegible] black-belt in judo—a man who had [illegible] his entire career in law enforcemen[illegible] peared as a rescuer. "There is a s[illegible] psychological need in Russia for [illegible] tective state, and Putin is pro[illegible] that," says the U.S. Ambassador t[illegible] sia Alexander Vershbow. Last su[illegible] for example, one hit song was [illegible] *Someone Like Putin*, in which a te[illegible] girl compares her layabout boyfrie[illegible] favorably to the ramrod-straight [illegible] dent. And as alarming as the Yuk[illegible] fair is to investors concerned [illegible] property rights, ordinary Russian[illegible] enjoying the spectacle of an olig[illegible] head in a vise and would undoub[illegible]

(TOP) PHOTOGRAPH BY V. SHAPOSHNIKOV/KOMMERSANT/ZUMA PRESS. (BOTTOM, L TO R) PHOTOGRAPHS BY GRANGER COLLECTION, GRANGER COLLECTION, HULTON DEUTSCH COLLECTION/CORBIS, BETTMANN/CORBIS, DMITRY DUKHANIN/KOMMERSANT 1/VISTA/SIPA PRESS

Russia's Vicious Cycle: Reform Followed by Reacti

THE DECEMBRIST REVOLT IN 1825

REFORM 1812-25

French Enlightenment spurs formation of secret anti-Czarist society of liberal aristocrats, the Decembrists.

REACTION 1825-55

A putsch attempt by the Decembrists is crushed by Czar Nicholas I, who establishes a new police-state regime.

REFORM 1855-81

Czar Alexander II frees the serfs in 1861, the highlight of a reform wave that spans his entire rule.

ALEXANDER II

REACTION 1882-1904

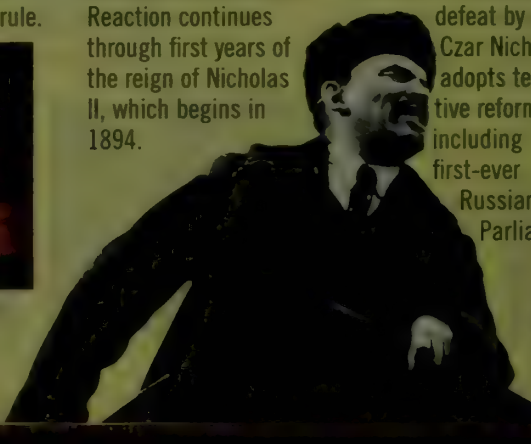
Alexander II killed by revolutionaries, spurring crackdown by successor Alexander III. Reaction continues through first years of the reign of Nicholas II, which begins in 1894.

REFORM 1905-17

Following workers' bloody uprising in St. Petersburg and Russia's humiliating defeat by Japan, Czar Nicholas II adopts tentative reforms, including first-ever Russian Parliament.

REAC 191

After Octobe[illegible] Bolsheviks [illegible] Cheka secre[illegible] crush rival [illegible] In 1935, Jos[illegible] launches th[illegible] Terror, blooc[illegible] ranks of pol[illegible] military Est[illegible] to consolida[illegible] dictatorial r[illegible] Reaction co[illegible] until his de[illegible]



LENIN IN RED SQUARE IN 1918

The KGB men Putin surrounds himself with seem to distrust the open society needed for economic growth

ort a wider crackdown: A recent in-ndent poll by the ROMIR Group l that nearly 80% favor revising the privatizations, with nearly 90% g they believe the tycoons acquired fortunes illegally.

ost Russians view Putin's paternal-approach favorably. Economic cir-tances, after all, have truly im-ed in many regions, not just in ow. Just before the Khodorkovsky began, I took a drive down to ga, a typical central Russian provin-city some 125 miles south of ow on the Oka River. Things are ig up, Vladimir Kondukov, the 48-old doctor who has run Kaluga's ealth department since 1995, told Kaluga's Soviet-era defense industry sed in the early 1990s. Things got d that ration cards were distrib-to locals for food. But now, a pri-economy has sprung up that in-s a thriving beer brewery and a machinery maker. Since 1998, the health budget has tripled, from llion to $9 million. "The worst is Kondukov told me.

om his office at City Hall, I headed e *rod dom*—the local maternity . a grey Soviet-era building tucked in a leafy patch of town. Kaluga is ipating in Russia's mini-boom in s, and Yelena Kruchilina's story typical. A 28-year-old lawyer, she een married for six years but did-el ready for children until she and husband, Andrei, a chauffeur, had enough to provide for a family. Now, she'll be going home with baby Danila to a new apartment, bought for $10,500 with some help from her parents. What's next? "We plan to have another child as soon as the doctor allows me," she says.

Arguably, Putin's top-down model for development has also provided succor to Russia's poorest regions. Under Yeltsin's loose rule, many regional governors took over Soviet-era businesses for themselves and refused to countenance competitors. The Putin team cracked down with a new law making it easier for the Kremlin to remove bad governors, then urged big Moscow oligarchs to help the poorest provinces.

No one outdid the philanthropic campaign, eccentric and grandiose even by Russian standards, mounted by oil and aluminum baron Roman A. Abramovich. In December, 2000, he won election as governor of the province of Chukotka, across the Bering Strait from Alaska, a forbidding land of reindeer and frozen tundra whose mostly unemployed 70,000 people suffered from tuberculosis and malnutrition. On a visit there during a frigid week in February, I found a staggering array of public-works projects under way, including a new electricity plant, schools, hospitals, a subsidized helicopter-transportation service, a Western-style supermarket, a Dolby-sound movie theater, an indoor hockey rink, and an English-style pub. The locals were grateful but puzzled. "Maybe the governor wants [us] to live like people live in Alaska," ventured Gennadi Baiborodov, general director of the local airline, ChukotAvia.

Back in Moscow, Abramovich told me he's paying for virtually all of these ventures out of his own pocket, to the tune of $200 million a year. But he has decided that his first term as governor will be his last. Shifting his focus to Great Britain, Abramovich recently bought Chelsea Football Club for $100 million. That has angered some in the Putin clan, who apparently view it as unpatriotic. In any case, there still is little private enterprise in Chukotka. Unless its people find a new benefactor, they may again find themselves shivering through the long, dark winters of the Arctic North.

The weakness of the Team Putin approach is also apparent in the crew's reluctance to proceed with market-oriented reforms that would benefit the economy but reduce their ability to manipulate strategic businesses for political ends. Gazprom, the bloated, state-controlled gas monopoly, is not being broken up, as liberal reformers had hoped. Instead, with Alexei Miller, a Putin loyalist, at the helm, it increasingly is being used to get former Soviet republics who still depend on Russia for their gas supplies to maintain allegiance to Moscow.

A key objective is the restoration of Russian influence in the Caucasus and Central Asia, where Moscow aims to counter Washington's growing clout. Under Defense Minister Sergei Ivanov, another of the men who worked with Putin in the KGB, Russia is building a new base in one

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REACTION

2000-03

On Jan. 1, 2000, ex-KGB Colonel Vladimir Putin takes over for ailing Yeltsin and consolidates his power with a clan of security-service buddies. After his election in March, his regime limits governors' powers and intimidates press with arrest of Kremlin critic Vladimir Gusinsky and forced sell-off of Gusinsky's NTV television station to state-controlled Gazprom. Gusinsky goes into exile, as does another prominent Putin critic, Boris Berezovsky.

SHUTTERED TV STATION

2003

March: In a Kremlin-ordered election widely seen as rigged, 96% of Chechens are officially declared to have approved a new constitution making the breakaway republic a part of Russia.

June: Putin's press ministry pulls the plug on TVS, Russia's last remaining privately owned national television network.

July: With parliamentary elections approaching in December, the business empire of titan Mikhail Khodorkovsky, a prime financial supporter of liberal political parties, is targeted by federal prosecutors. His partner is arrested and detained and his Yukos oil company's offices are raided.

Data: *BusinessWeek*

PRESIDENT PUTIN VOTING IN 2000

gas-dependent republic, Kyrgyzstan, and reinforcing one in Armenia.

Notwithstanding Putin's pragmatic desire for cooperative relations with Washington, the siloviki intensely distrust America. They are envious of U.S. technological and economic prowess but disdainful of, or perhaps just puzzled by, America's political philosophy—they just don't seem to get that liberal values are essential to creating an open society in which business and science can thrive. Putin's camp believes in "enlightened autocracy," says ex-KGB agent Velichko. Among the fraternity of Russian security-service officers, the KGB is in fact an elite, patriotic calling, which traces its roots back to Czar Nicholas I, who in 1825 created "the higher police" in his effort to modernize Russia at a disciplined pace. Westerners may see the KGB crowd as thugs, but many, Putin included, have professional degrees (he's a lawyer by training) and pride themselves on their understanding of statecraft. Yet they have an inbred mistrust of democracy, and this mindset makes unlikely a genuine compatibility, a lasting, deep alliance, between the Russia of the Putin regime and America and other Western countries. Overall, "Russia seems more similar to our culture than it really is," notes U.S. Ambassador Vershbow. "There is this whole shadow world in the corridors of power."

So the Putin crew controls defense policy. It has the oligarchs mostly whipped and the media under control. There are still liberal reformers left in the government, but their influence appears to be diminishing. But there's one force Putin's team may not be able to control: demographics.

You might think economic growth would be making Russians healthier. But apart from the modest rise in the birthrate and a slight decline in infant mortality, there is little sign of this so far. Since 1998, life expectancy for men has actually declined, from 61.3 years to 58.5.

The big problem is—you guessed it—vodka. It's sometimes said that Russians, and particularly Russian men, binge on the bottle as a path to oblivion for relief from the general misery of life. But data indicate that Russians drink when times are bad—and they drink even more when times get better.

PAST AND FUTURE
Many Russians find Putin's paternalism comforting

Last year, a time of prosperity, Russian vodka production rose 7% over 2001's, to 1.4 billion liters, the highest in eight years. Widespread alcoholism brings death in numerous ways—heart disease, car accidents, violent brawling. Excessive drinking and other bodily abuse is a kind of cultural legacy in Russia, as Yevgeny Andreyev, a mathematician at the Russian Academy of Sciences, sees it—the result of live-for-today attitudes formed by the experience of so many calamities.

Thus, the death rate in Russia is nearly twice the birthrate—17 Russians die for every 10 who are born. Grimmer still, the World Bank is predicting that an AIDS epidemic will strike Russia in 2005-2010 as a result of what is already a major spread of HIV infection, the precursor to AIDS. If AIDS is not brought under control, the government's own, hardly sunny, forecast—a 30% decline from today's 145 million people, to 101 million by 2050—could prove overly optimistic. "The numbers are mind-boggling," says demographer Murray Feshbach at the Woodrow Wilson International Center for Scholars in Washington. Left unchecked, the spread of AIDS could have "a devastating long-term effect on the stability of health and pension systems" in Russia, warns the World Bank. Private savings would have to be diverted into AIDS treatment, potentially reducing GDP by 4.15% by 2010 and 10.5% by 2010. Investment would decline even more, says the World Bank.

Although Putin is citi
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Russia, you are a heartbreaker.
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people, and many of their tradition
sweet and poignant. On a recent
day, I boarded the Tolstoy Expr
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Polyana also is a place of pilgrima
just-marrieds who take celebratory
along footpaths bordered by app
chards and white birches.

I arrived on an unseasonably
and windy day. Shivering in thei
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Friends snapped pictures and unc
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of the newlyweds, *za schastye*
dych. Tolstoy, who never stoppe
lieving in Russia even as he
against its multitudinous faults,
surely be pleased.

BusinessWeek online
For an extensive interview with Khodorkovsky, go to www.businessweek.com/magazine/extra

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COMMENTARY

By Mark L. Clifford

SHOULD CHINA REVALUE? SOON, IT MAY HAVE NO CHOICE

The debate over revaluing the Chinese yuan is gathering steam. For weeks, everyone from Fed Chairman Alan Greenspan to European Central Bank President Wim Duisenberg has been warning of the consequences if Beijing does not revalue its currency, which at its current fixed rate of 8.28 to the greenback may be undervalued by up to 30%. Western policymakers argue that the artificially cheap currency is ruining other nations' ability to compete in global trade and building up a dangerously large current-account surplus, which adds up to $100 billion just for the last 12 months. Chinese officials, politely but firmly, have told the West: Get lost. China's domestic economy needs to soak up millions of jobless workers. Cheap exports are vital in this exercise. No way is a major revaluation possible.

A stalemate? Seems like it. But it may not be the political debate that determines which way the yuan will really go. Look instead at the day-to-day flow of money across China's ever more porous border. In this realm, stockbrokers, fund managers, corporate executives, and currency traders are all betting on a revaluation by pouring money into the country.

What money bears watching? One number to look at is something called "the errors and omissions" item in the balance of payments statistics that governments publish every year. The balance of payments exercise is simply a bird's-eye view of overall flows of money into and out of a country. If the numbers show more money moving in and out than the official stats suggest, then the country records that sum in the errors and omissions category, which exists to balance discrepancies. This category is also the best proxy for showing the existence of underground, cross-border money flows that a government cannot detect.

In China's case, the errors and omissions category showed a steady flight from yuan-denominated assets from 1990 to 2001. What was happening? Many Chinese wanted to skirt China's strict currency controls and get their money out of the country, whether to give extra spending money to children studying abroad or to spirit out ill-gotten gains. Throughout the '90s, thousands of mainland Chinese literally carried suitcases of money into Hong Kong, where they converted it into Hong Kong or U.S. dollars, or Hong Kong real estate and stocks. The slow, steady leak of money indicated that even the Chinese thought their money was safer in other currencies. All told, errors and omissions added up to $136 billion flowing out of China between 1989 and 2001.

But the money flow has abruptly reversed. In 2002 China recorded a net surplus in its errors and omissions cash flow of $7.8 billion. Traders say this is a sign that many expect the yuan to be revalued. So buy yuan now, enjoy a big appreciation later. "Everyone knows that the [yuan] will go up," says a currency trader in Beijing.

It's not just Chinese making this bet. Foreign banks, which were just given the right to buy stock exchange A-shares formerly restricted to mainland investors, are poised to spend billions, in part to show their commitment to China but also to take advantage of a future revaluation in the yuan. The same thinking is affecting new investments in factories and other projects.

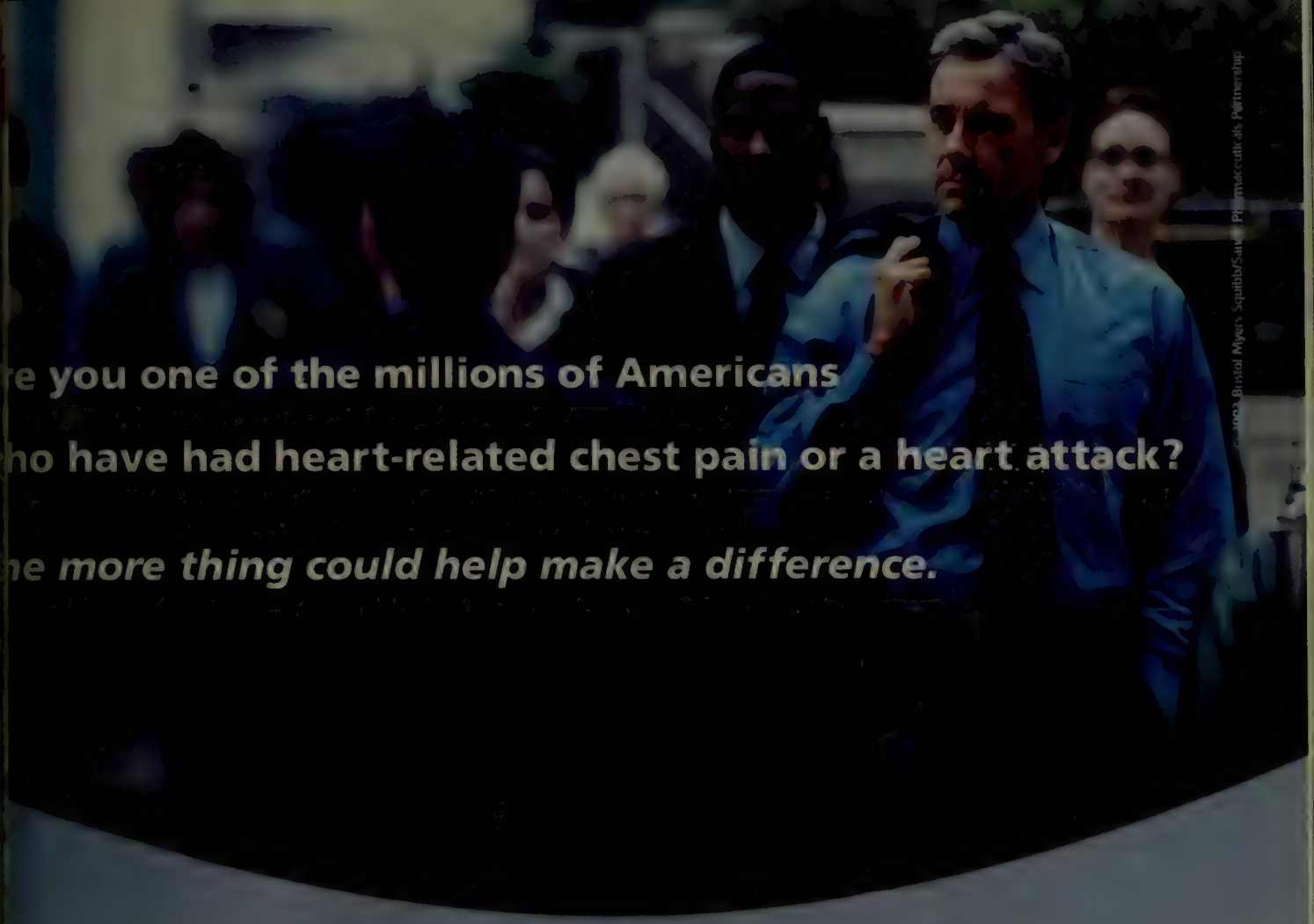
All the money rushing into China distorts the domestic economy, and that could force the government's hand. Because China limits foreign currency holdings, the central People's Bank of China must buy foreign currency from Chinese companies and individuals. They in turn spend much of the newly minted yuan on real estate, which has begun to overheat. The People's Bank is trying to limit the impact of this massive money injection by selling bonds to soak up liquidity. But this "sterilization" of currency inflows can't continue indefinitely. If money keeps streaming in, bond issuance to absorb it could get out of hand, making the interest alone a drag on state finances. "They should make a change quickly," says Yiping Huang, an economist for Citigroup in Hong Kong. "Otherwise, you build up distortions."

As businessmen and currency traders see it, Beijing has only one choice: a revaluation that makes the yuan more expensive. Beijing may not heed Greenspan. But the slow, steady pressure of the markets is another matter.

With Dexter Roberts Beijing

$7.8 BILLION The estimated amount of gray-market money that flowed back into China in 2002

$100 BILLION The buildup in China's foreign currency reserves over the last 12 months



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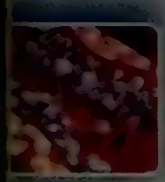
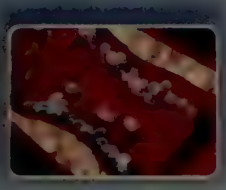
VIX,® added to aspirin and your current ications, helps raise your protection against re heart attack or stroke. If you've been italized for heart-related chest pain or a certain of heart attack, conditions that doctors call or Acute Coronary Syndrome, ask your or about adding PLAVIX.



For most, heart attack or stroke is caused when platelets form clots that block the flow of blood to the heart or brain.
k aspirin and your other medications alone are gh? Adding PLAVIX could help protect you st a future heart attack or stroke.



PLAVIX and your other medications work in different ways. Adding PLAVIX can go beyond your current treatment. Prescription PLAVIX, taken with aspirin, plays its own role in keeping platelets from sticking together and forming clots—which helps keep blood flowing.

Talk to your doctor about PLAVIX. For more information, visit www.plavix.com or call 1-888-440-6899.

ONCE-A-DAY
Plavix®
(clopidogrel bisulfate) 75mg tablets

Add more protection against heart attack or stroke

ORTANT INFORMATION: If you have a medical condition that causes bleeding, such as stomach ulcer, should not use PLAVIX. The risk of bleeding may increase with PLAVIX, and when you take PLAVIX certain other medicines, including aspirin. Review your medicines with your doctor to minimize this Additional rare, but serious, side effects could occur.

e see important product information on the following page.

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PLAVIX®

clopidogrel bisulfate tablets

BRIEF SUMMARY— Please see package insert for full prescribing information

INDICATIONS AND USAGE: PLAVIX (clopidogrel bisulfate) is indicated for the reduction of thrombotic events as follows.

- **Recent MI, Recent Stroke or Established Peripheral Arterial Disease**
  For patients with a history of recent myocardial infarction (MI), recent stroke, or established peripheral arterial disease. PLAVIX has been shown to reduce the rate of a combined endpoint of new ischemic stroke (fatal or not), new MI (fatal or not), and other vascular death.
- **Acute Coronary Syndrome**
  For patients with acute coronary syndrome (unstable angina/non-Q-wave MI), including patients who are to be managed medically and those who are to be managed with percutaneous coronary intervention (with or without stent) or CABG. PLAVIX has been shown to decrease the rate of a combined endpoint of cardiovascular death, MI, or stroke as well as the rate of a combined endpoint of cardiovascular death, MI, stroke, or refractory ischemia.

CONTRAINDICATIONS: The use of PLAVIX is contraindicated in patients with a hypersensitivity to the drug substance or any component of the product, and those with active pathological bleeding such as peptic ulcer or intracranial hemorrhage.

WARNINGS: *Thrombotic thrombocytopenic purpura (TTP)*: TTP has been reported rarely following use of PLAVIX, sometimes after a short exposure (<2 weeks). TTP is a serious condition requiring prompt treatment. It is characterized by thrombocytopenia, microangiopathic hemolytic anemia (schistocytes [fragmented RBCs] seen on peripheral smear), neurological findings, renal dysfunction, and fever. TTP was not seen during clopidogrel's clinical trials, which included over 17,500 clopidogrel-treated patients. In world-wide postmarketing experience, however, TTP has been reported at a rate of about four cases per million patients exposed, or about 11 cases per million patient-years. The background rate is thought to be about four cases per million person-years.

PRECAUTIONS: General: As with other antiplatelet agents, PLAVIX prolongs the bleeding time and therefore should be used with caution in patients who may be at risk of increased bleeding from trauma, surgery, or other pathological conditions (particularly gastrointestinal and intraocular). If a patient is to undergo elective surgery and an antiplatelet effect is not desired, PLAVIX should be discontinued 5 days prior to surgery. Due to the risk of bleeding and undesirable hematological effects, blood cell count determination and/or other appropriate testing should be promptly considered whenever such suspected clinical symptoms arise during the course of treatment (see ADVERSE REACTIONS). *GI Bleeding*: In CAPRIE, PLAVIX was associated with a rate of gastrointestinal bleeding of 2.0% vs. 2.7% on aspirin. In CURE, the incidence of major gastrointestinal bleeding was 1.3% vs. 0.7% (PLAVIX + aspirin vs placebo + aspirin, respectively). PLAVIX should be used with caution in patients who have lesions with a propensity to bleed (such as ulcers). Drugs that might induce such lesions should be used with caution in patients taking PLAVIX. *Use in Hepatically-Impaired Patients*: Experience is limited in patients with severe hepatic disease who may have bleeding diatheses. PLAVIX should be used with caution in this population. *Use in Renally-Impaired Patients*: Experience is limited in patients with severe renal impairment. PLAVIX should be used with caution in this population.

Information for Patients: Patients should be told that it may take them longer than usual to stop bleeding when they take PLAVIX, and that they should report any unusual bleeding to their physician. Patients should inform physicians and dentists that they are taking PLAVIX before any surgery is scheduled and before any new drug is taken.

Drug Interactions: Study of specific drug interactions yielded the following results: *Aspirin:* Aspirin did not modify the clopidogrel-mediated inhibition of ADP-induced platelet aggregation. Concomitant administration of 500 mg of aspirin twice a day for 1 day did not significantly increase the prolongation of bleeding time induced by PLAVIX. PLAVIX potentiated the effect of aspirin on collagen-induced platelet aggregation. PLAVIX and aspirin have been administered together for up to one year. *Heparin*: In a study in healthy volunteers, PLAVIX did not necessitate modification of the heparin dose or alter the effect of heparin on coagulation. Coadministration of heparin had no effect on inhibition of platelet aggregation induced by PLAVIX. *Nonsteroidal Anti-Inflammatory Drugs (NSAIDs)*: In healthy volunteers receiving naproxen, concomitant administration of PLAVIX was associated with increased occult gastrointestinal blood loss. NSAIDs and PLAVIX should be coadministered with caution. *Warfarin*: The safety of the coadministration of PLAVIX with warfarin has not been established. Consequently, concomitant administration of these two agents should be undertaken with caution (See **Precautions–General**). *Other Concomitant Therapy*: No clinically significant pharmacodynamic interactions were observed when PLAVIX was coadministered with **atenolol, nifedipine**, or both atenolol and nifedipine. The pharmacodynamic activity of PLAVIX was also not significantly influenced by the coadministration of **phenobarbital, cimetidine or estrogen.** The pharmacokinetics of **digoxin** or **theophylline** were not modified by the coadministration of PLAVIX (clopidogrel bisulfate). At high concentrations *in vitro*, clopidogrel inhibits P_{450} 2C9. Accordingly, PLAVIX may interfere with the metabolism of **phenytoin, tamoxifen, tolbutamide, warfarin, torsemide, fluvastatin** and many **non-steroidal anti-inflammatory agents,** but there are no data with which to predict the magnitude of these interactions. Caution should be used when any of these drugs is coadministered with PLAVIX. In addition to the above specific interaction studies, patients entered into clinical trials with PLAVIX received a variety of concomitant medications **including diuretics, beta-blocking agents, angiotensin converting enzyme inhibitors, calcium antagonists, cholesterol lowering agents, coronary vasodilators, antidiabetic agents (including insulin), antiepileptic agents, hormone replacement therapy, heparins** (unfractionated and LMWH), and **GPIIb/IIIa antagonists** without evidence of clinically significant adverse interactions. The use of oral anticoagulants, non-study anti-platelet drug and chronic NSAIDs was not allowed in CURE and there are no data on their concomitant use with clopidogrel.

Drug/Laboratory Test Interactions: None known.

Carcinogenesis, Mutagenesis, Impairment of Fertility: There was no evidence of tumorigenicity when clopidogrel was administered for 78 weeks to mice and 104 weeks to rats at dosages up to 77 mg/kg per day, which afforded plasma exposures >25 times that in humans at the recommended daily dose of 75 mg. Clopidogrel was not genotoxic in four *in vitro* tests (Ames test, DNA-repair test in rat hepatocytes, gene mutation assay in Chinese hamster fibroblasts and metaphase chromosome analysis of human lymphocytes) and in one *in vivo* test (micronucleus test by oral route in mice). Clopidogrel was found to have no effect on fertility of male and female rats at oral doses up to 400 mg/kg per day (52 times the recommended human dose on a mg/m² basis).

Pregnancy: Pregnancy Category B. Reproduction studies performed in rats and rabbits at doses up to 500 and 300 mg/kg/day (respectively, 65 and 78 times the recommended daily human dose on a mg/m² basis) revealed no evidence of impaired fertility or fetotoxicity due to clopidogrel. There are, however, no adequate and well-controlled studies in pregnant women. Because animal reproduction studies are not always predictive of a human response, PLAVIX should be used during pregnancy only if clearly needed.

Nursing Mothers: Studies in rats have shown that clopidogrel and/or its metabolites are excreted in the milk. It is not known whether this drug is excreted in human milk. Because many drugs are excreted in human milk and because of the potential for serious adverse reactions in nursing infants, a decision should be made whether to discontinue nursing or to discontinue the drug, taking into account the importance of the drug to the nursing woman.

Pediatric Use: Safety and effectiveness in the pediatric population have not been established.

ADVERSE REACTIONS: PLAVIX has been evaluated for safety in more than 17,500 patients, including over 9,000 patients treated for 1 year or more. The overall tolerability of PLAVIX in CAPRIE was similar to that of aspirin regardless of age, gender and race, with an approximately equal incidence (13%) of patients withdrawing from treatment because of adverse reactions. The clinically important adverse events observed in CAPRIE and CURE are discussed below.

Hemorrhagic: In CAPRIE patients receiving PLAVIX, gastrointestinal hemorrhage occurred at a rate of 2.0% and required hospitalization in 0.7%. In patients receiving aspirin, the corresponding rates were 2.7% and 1.1%, respectively. The incidence of intracranial hemorrhage was 0.4% for PLAVIX compared to 0.5% for aspirin.

In CURE, PLAVIX use with aspirin was associated with an increase in bleeding compared to placebo with aspirin (see Table 3). There was an excess in major bleeding in patients receiving PLAVIX plus aspirin compared with placebo plus aspirin, primarily gastrointestinal and at puncture sites. The incidence of intracranial hemorrhage (0.1%), and fatal bleeding (0.2%), was the same in both groups.

In patients receiving both PLAVIX and aspirin in CURE, the incidence of bleeding is described below.

CURE Incidence of bleeding complications (% patients)

Event	PLAVIX (+ aspirin)* (n=6259)	Placebo (+ aspirin)* (n=6303)	P-value
Major bleeding†	3.7‡	2.7§	0.001
Life-threatening bleeding	2.2	1.8	0.13
Fatal	0.2	0.2	
5 g/dL hemoglobin drop	0.8	0.9	
Requiring surgical intervention	0.7	0.7	
Hemorrhagic strokes	0.1	0.1	
Requiring inotropes	0.5	0.5	
Requiring transfusion (≥4 units)	1.2	1.0	
Other major bleeding	1.6	1.0	0.005
Significantly disabling	0.4	0.3	
Intraocular bleeding with significant loss of vision	0.05	0.03	
Requiring 2-3 units of blood	1.3	0.8	
Minor bleeding¶	5.1	2.4	<0.001

* Other standard therapies were used as appropriate.
† Life threatening and other major bleeding.
‡ Major bleeding event rate for PLAVIX + aspirin was dose-dependent on aspirin: <100 mg=2.6%, 100-200 mg=3.5%, >200 mg=4.9%.
§ Major bleeding event rate for placebo + aspirin was dose-dependent on aspirin: <100 mg=2.0%, 100-200 mg=2.3%, >200 mg=4.0%.
¶ Led to interruption of study medication.

Ninety-two percent (92%) of the patients in the CURE study received heparin/LMWH, and the rate of bleeding in these patients was similar to the overall results.

There was no excess in major bleeds within seven days after coronary bypass graft surgery in patients who stopped therapy more than five days prior to surgery; event rate 4.4% PLAVIX + aspirin, 5.3% placebo + aspirin). In patients who remained on therapy within five days of bypass graft surgery, the event rate was 9.6% for PLAVIX + aspirin, and 6.3% for placebo + aspirin.

Neutropenia/agranulocytosis: Ticlopidine, a drug chemically similar to PLAVIX, is associated with a 0.8% rate of severe neutropenia (less than 450 neutrophils/µL). In CAPRIE severe neutropenia was observed in six patients, four on PLAVIX and two on aspirin. Two of the 9599 patients who received PLAVIX and none of the 9586 patients who received aspirin had neutrophil counts of zero. One of the four PLAVIX patients in CAPRIE was receiving cytotoxic chemotherapy, and another recovered and returned to the trial after only temporarily interrupting treatment with PLAVIX (clopidogrel bisulfate). In CURE, the numbers of patients with thrombocytopenia (19 PLAVIX + aspirin vs 24 placebo + aspirin) or neutropenia (3 vs 3) were similar.

Although the risk of myelotoxicity with PLAVIX thus appears to be quite low, this possibility should be considered when a patient receiving PLAVIX demonstrates fever or other sign of infection.

Gastrointestinal: Overall, the incidence of gastrointestinal events (e.g. abdominal pain, dyspepsia, gastritis and constipation) in patients receiving PLAVIX (clopidogrel bisulfate), was 27.1%, compared to 29.8% in those receiving aspirin in the CAPRIE trial. In the CURE trial the incidence of these gastrointestinal events for patients receiving PLAVIX + aspirin was 11.7% compared to 12.5% for those receiving + aspirin.

In the CAPRIE trial, the incidence of peptic, gastric or duodenal ulcers was 0.7% for PLAVIX and 1.2% for aspirin. In the CURE trial, the incidence of peptic, gastric or duodenal ulcers was 0.4% for PLAVIX + aspirin and 0.3% for placebo + aspirin.

Cases of diarrhea were reported in the CAPRIE trial in 4.5% of patients in the PLAVIX group compared to 3.4% in the aspirin group. However, these were rarely severe (PLAVIX=0.2% and aspirin=0.1%). In the CURE trial, the incidence of diarrhea for patients receiving + aspirin was 2.1% compared to 2.2% for those receiving placebo + aspirin.

In the CAPRIE trial, the incidence of patients withdrawing from treatment because of gastrointestinal adverse reactions was 1.8% for PLAVIX and 4.0% for aspirin. In the CURE trial, the incidence of patients withdrawing from treatment because of gastrointestinal actions was 0.9% for PLAVIX + aspirin compared with 0.8% for placebo + aspirin.

Rash and Other Skin Disorders: In the CAPRIE trial, the incidence of skin and appendage disorders in patients receiving PLAVIX (0.7% serious), the corresponding rate in aspirin patients was 1.3% (0.5% serious). In the CURE trial the incidence of rash or other orders in patients receiving PLAVIX + aspirin was 4.0% compared to 3.5% for those receiving placebo + aspirin.

In the CAPRIE trial, the overall incidence of patients withdrawing from treatment because of skin and appendage disorders actions was 1.5% for PLAVIX and 0.8% for aspirin. In the CURE trial, the incidence of patients withdrawing because of skin and appendorders adverse reactions was 0.7% for PLAVIX + aspirin compared with 0.3% for placebo + aspirin.

Adverse events occurring in ≥2.5% of patients on PLAVIX in the CAPRIE controlled clinical trial are shown below regardless of to PLAVIX. The median duration of therapy was 20 months, with a maximum of 3 years.

Adverse Events Occurring in ≥2.5% of PLAVIX Patients in CAPRIE

Body System / Event	% Incidence (% Discontinuation) PLAVIX (n=9599)		Aspirin (n=9586)	
Body as a Whole — general disorders				
Chest Pain	4.1	(0.2)	3.8	(0.1)
Accidental/Inflicted Injury	7.9	(0.1)	7.3	(0.1)
Influenza-like symptoms	7.5	(<0.1)	7.0	(<0.1)
Pain	6.4	(0.1)	5.8	(0.1)
Fatigue	3.3	(0.1)	3.4	(0.1)
Cardiovascular disorders, general				
Edema	4.1	(<0.1)	4.5	(<0.1)
Hypertension	4.3	(<0.1)	5.1	(<0.1)
Central & peripheral nervous system disorders				
Headache	7.6	(0.3)	7.2	(0.2)
Dizziness	6.2	(0.2)	6.7	(0.3)
Gastrointestinal system disorders				
Abdominal pain	6.6	(0.7)	7.1	(1.0)
Dyspepsia	5.2	(0.6)	6.1	(0.7)
Diarrhea	4.5	(0.4)	3.4	(0.3)
Nausea	3.4	(0.3)	3.8	(0.4)
Metabolic & nutritional disorders				
Hypercholesterolemia	4.0	(0)	2.4	(<0.1)
Musculo-skeletal system disorders				
Arthralgia	6.1	(0.1)	6.2	(0.1)
Back Pain	5.8	(0.1)	5.3	(<0.1)
Platelet, bleeding, & clotting disorders				
Purpura/Bruise	5.3	(0.2)	3.7	(0.1)
Epistaxis	2.9	(0.2)	2.5	(0.1)
Psychiatric disorders				
Depression	3.6	(0.1)	3.9	(0.3)
Respiratory system disorders				
Upper resp tract infection	8.7	(<0.1)	8.8	(<0.1)
Dyspnea	4.5	(0.1)	4.7	(0.1)
Rhinitis	4.2	(0.1)	4.2	(<0.1)
Bronchitis	3.7	(0.1)	3.7	(0.1)
Coughing	3.1	(<0.1)	2.7	(<0.1)
Skin & appendage disorders				
Rash	4.2	(0.3)	3.5	(0.3)
Pruritus	3.3	(0.3)	1.6	(0.1)
Urinary system disorders				
Urinary tract infection	3.1	(0)	3.5	(0.1)

Incidence of discontinuation, regardless of relationship to therapy, is shown in parentheses.

Adverse events occurring in ≥2.0% of patients on PLAVIX in the CURE controlled clinical trial are shown below regardless of relationship

Adverse Events Occurring in ≥2.0% of PLAVIX Patients in CURE

Body System / Event	% Incidence (% Discontinuation) PLAVIX (+ aspirin)* [n=6259]		Placebo (+ aspirin)* [n=6303]	
Body as a Whole–general disorders				
Chest Pain	2.7	(<0.1)	1.8	(0.0)
Central & peripheral nervous system disorders				
Headache	3.1	(0.1)	3.2	(0.1)
Dizziness	2.4	(0.1)	2.0	(<0.1)
Gastrointestinal system disorders				
Abdominal pain	2.3	(0.3)	2.8	(0.3)
Dyspepsia	2.0	(0.1)	1.9	(<0.1)
Diarrhea	2.1	(0.1)	2.2	(0.1)

* Other standard therapies were used as appropriate.

Other adverse experiences of potential importance occurring in 1% to 2.5% of patients receiving PLAVIX (clopidogrel bisulfate) in CAPRIE or CURE controlled clinical trials are listed below regardless of relationship to PLAVIX. In general, the incidence of these events was similar to that in patients receiving aspirin (in CAPRIE) or placebo + aspirin (in CURE).

Autonomic Nervous System Disorders: Syncope, Palpitation. *Body as a Whole - general disorders*: Asthenia, Fever, Hernia. *Cardiac disorders*: Cardiac failure. *Central and peripheral nervous system disorders*: Cramps legs, Hypoaesthesia, Neuralgia, Paraesthesia. *Gastrointestinal system disorders*: Constipation, Vomiting. *Heart rate and rhythm disorders*: Fibrillation atrial. *Liver and biliary system disorders*: Hepatic enzymes increased. *Metabolic and nutritional disorders*: Gout, hyperuricemia, non-protein nitrogen (NPN) increased. *Musculoskeletal system disorders*: Arthritis, Arthrosis. *Platelet, bleeding & clotting disorders*: GI hemorrhage, hematoma, platelets d. *Psychiatric disorders*: Anxiety, Insomnia. *Red blood cell disorders*: Anemia. *Respiratory system disorders*: Pneumonia, Sinusitis. *Skin & appendage disorders*: Eczema, Skin ulceration. *Urinary system disorders*: Cystitis. *Vision disorders*: Cataract, Conjunctivitis.

Other potentially serious adverse events which may be of clinical interest but were rarely reported (<1%) in patients who received PLAVIX in the CAPRIE or CURE controlled clinical trials are listed below regardless of relationship to PLAVIX. In general, the incidence of these events was similar to that in patients receiving aspirin (in CAPRIE) or placebo + aspirin (in CURE). *Body as a whole*: Allergic reaction, anaphylactoid reaction, ischemic. *Cardiovascular disorders*: Edema generalized. *Gastrointestinal system disorders*: Gastric ulcer perforated, gastritis hemorrhagic, upper GI ulcer hemorrhagic. *Liver and Biliary system disorders*: Bilirubinemia, hepatitis infectious, liver fatty. *Platelet, bleeding and clotting disorders*: hemarthrosis, hematuria, hemoptysis, hemorrhage intracranial, hemorrhage retroperitoneal, hemorrhage of operative wound, ocular hemorrhage, pulmonary hemorrhage, purpura allergic, thrombocytopenia. *Red blood cell disorders*: Anemia aplastic, anemia hypochromic. *Reproductive disorders, female*: Menorrhagia. *Respiratory system disorders*: Hemothorax. *Skin and appendage disorders*: Bullous rash, erythematous, rash maculopapular, urticaria. *Urinary system disorders*: Abnormal renal function, acute renal failure. *White cell and reticuloendothelial system disorders*: Agranulocytosis, granulocytopenia, leukemia, leukopenia, neutrophils decreased.

Postmarketing Experience: The following events have been reported spontaneously from worldwide postmarketing experience: *Body as a whole*: hypersensitivity reactions, anaphylactoid reactions. *Central and Peripheral Nervous System disorders*: confusion, hallucinatory disorders. *Liver and Biliary system disorders*: abnormal liver function test, hepatitis (non-infectious). *Platelet, Bleeding and Clotting disorders*: cases of bleeding with fatal outcome (especially intracranial, gastrointestinal and retroperitoneal hemorrhage), agranulocytosis, aplastic anemia/pancytopenia, thrombotic thrombocytopenic purpura (TTP) – see WARNINGS (conjunctival, ocular and retinal bleeding). *Respiratory system disorders*: bronchospasm. *Skin and Appendage disorders*: angioedema, erythema multiforme. *Urinary system disorders*: glomerular abnormal creatinine levels.

OVERDOSAGE: One case of deliberate overdosage with PLAVIX was reported in the large, CAPRIE controlled clinical study. A 34-year-old woman took a single 1,050-mg dose of PLAVIX (equivalent to 14 standard 75-mg tablets). There were no associated adverse events. Medicinal therapy was instituted, and she recovered without sequelae. No adverse events were reported after single oral administration of 300 mg (equivalent to 8 standard 75-mg tablets) of PLAVIX in healthy volunteers. The bleeding time was prolonged by a factor of 1.7, which is similar to that typically observed with the therapeutic dose of 75 mg of PLAVIX per day. A single oral dose of clopidogrel at 1500 or 2000 mg/kg was lethal to mice and to rats and at 3000 mg/kg to baboons. Symptoms of acute toxicity were vomiting (in baboons), prostration, labored breathing, and gastrointestinal hemorrhage in all species.

Recommendations About Specific Treatment: Based on biological plausibility, platelet transfusion may be appropriate to reverse the pharmacological effects of PLAVIX if quick reversal is required.

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ED BY ROSE BRADY

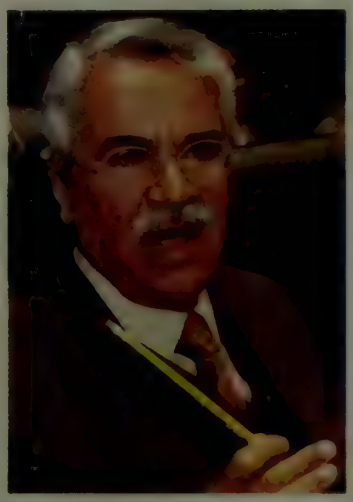
UDDENLY, THE SAUDIS 'ANT TO CLOSE SOME DEALS

ou want to see how the overthrow of Saddam Hussein Iraq may be changing the Middle East, you need look no ther than the breakthrough gas deal signed by Royal h/Shell Group and Total Group in Saudi Arabia. The d is the first to allow foreign companies to explore and ice gas since the industry was nationalized in the mid-s. It goes a long way toward salvaging a high-profile ef- to bring in the companies that Crown Prince Abdullah nnounced five years ago.

uabbling between the companies and the i oil bureaucracy had just about killed llah's initiative. Not only was this an em-ssment for the kingdom's de facto ruler t was also a disaster for Saudi efforts to ct other investment—which is badly need- provide jobs for a fast-growing popula- Then, Saddam's demise put a spotlight he shortcomings of neighboring leaders neant that Iraq would soon be competing he oil companies' capital.

umors flew that the Crown Prince would Oil Minister Ali Al-Naimi, who is considered ical of foreign involvement, in a May Cab- shuffle. Instead, Al-Naimi was retained and a freer hand—but with the understanding ould have to produce results. After five of dithering, the dapper Minister moved He streamlined the cumbersome process had just about doomed Abdullah's initiative. The Saudis trying to force the companies not only to explore for gas o build power, water, and chemical plants—all in three ages estimated to cost $25 billion. Al-Naimi separated gas ities from the downstream albatrosses. Following several s of talks, on July 16, the Saudis awarded a consortium—y Shell and including Total and the national oil company, i Aramco—a 77,000-square-mile area in the remote Emp- uarter to explore for gas. Shell has a 40% stake, while To-tal and Saudi Aramco each hold 30%. "After a few years of negotiation, it was obvious that there must be a different way of doing business," Al-Naimi told reporters on July 21.

He also turned Saudi Aramco from a potential obstacle to a supporter of the deal, persuading Aramco to take the stake allocated to ConocoPhillips after the U.S. company dropped out just an hour before the signing. ConocoPhillips said the deal didn't meet its profit criteria. In another sign of change, Aramco will pay its way rather than get a free share because of its position.



AL-NAIMI: *No dithering*

Al-Naimi is no longer demanding that the companies make enormous commitments in return for limited access to Saudi hydrocarbons. Instead, Shell and Total have agreed to spend around $200 million over five years on exploration. If they find nothing, they can walk away. The companies will sell whatever gas they find and can report the reserves on their books—which they can't do in Kuwait and Iran. While it is difficult to gauge profits, the companies expect they will be 15% or so—the low end of what they consider acceptable. Although the deal does not include oil, the companies suspect that down the road they might be able to produce and sell any oil they find—now taboo in Saudi Arabia. Thus, the upside gains could be huge.

If so, Shell and Total will have a head start. Exxon Mobil Corp., the other big player in the gas talks, didn't come to an agreement with the Saudis, raising questions about whether it misread the Saudis' new attitude. But Al-Naimi is giving them another shot. He held a conference in London on July 21-22 to offer up three more blocks in the 12,000- to 20,000-square-mile range. "It is going to be the most transparent process you can have," he declared. That would be quite a shift indeed.

By Stanley Reed in London

GLOBAL WRAPUP

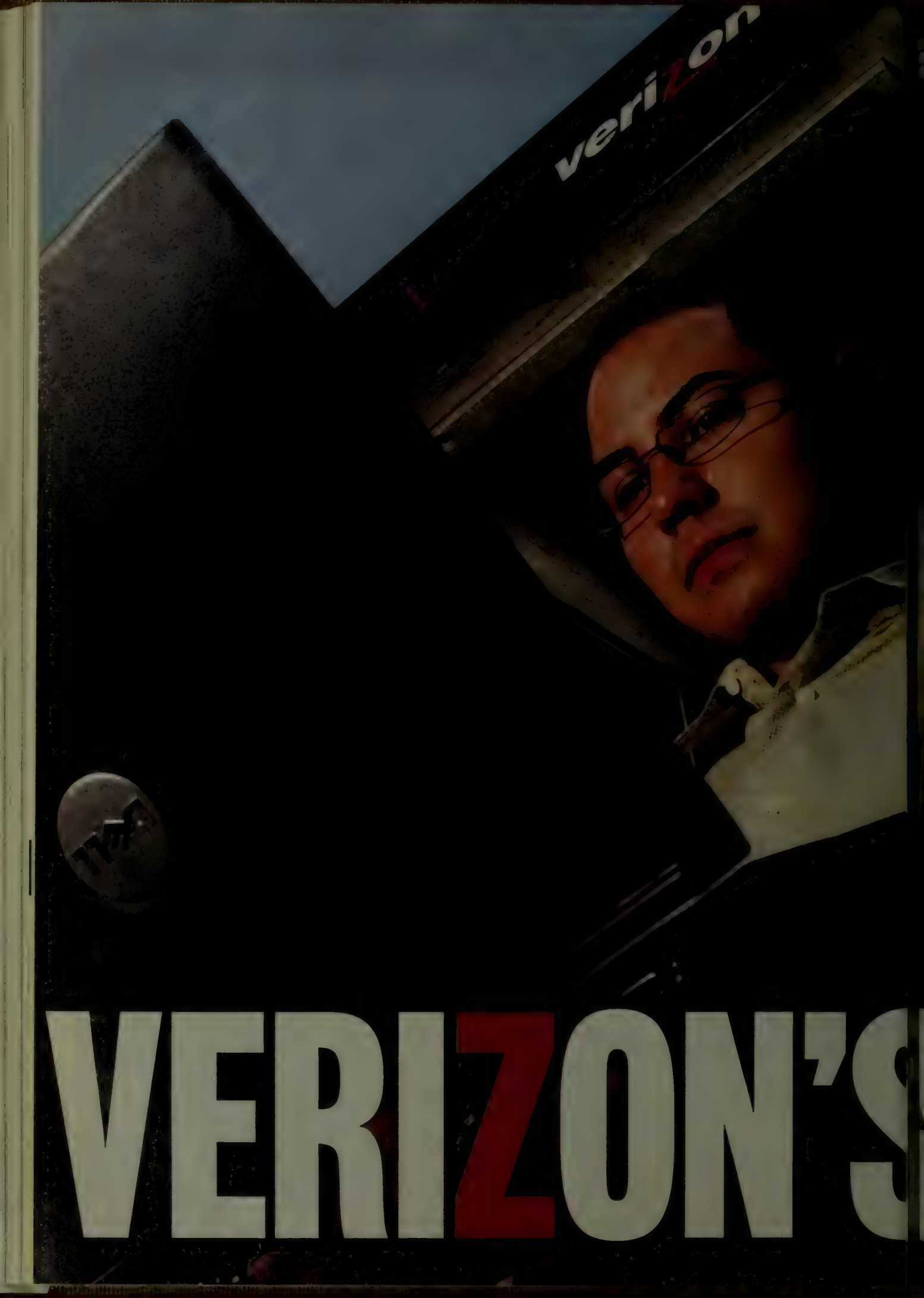
E VISE TIGHTENS ON BURMA

he military government of Burma, ich calls itself Myanmar, is coming ler the heaviest pressure yet to re- se opposition leader Aung San Suu i from nearly two months of deten- in Rangoon. President Bush is n expected to sign the Burmese edom & Democracy Act of 2003, ich bans Burmese garment exports he U.S. worth $356 million and ezes the junta's assets at U.S. fi- ncial institutions around the world. laysian Prime Minister Mahathir Mohamad is also threatening to have Burma expelled from the Association of Southeast Asian Nations.

It's unclear how the junta will respond. The generals have mismanaged the economy since they seized power in 1988, so sanctions may not have much effect. Moreover, they are afraid of Suu Kyi, 58, the daughter of Burma's founding father. She was elected to the country's still-nonexistent national assembly in a poll that her party, the National League for Democracy, won by a landslide in 1990.

Rather than recognizing her victory, the junta held her under various forms of detention intermittently, finally releasing her in May, 2002. They arrested her again on May 30. Her popularity had soared after a financial crisis spurred a run on commercial banks. Diplomats say the generals are now seeking a face-saving compromise. On July 23 the junta said it had released 91 political prisoners, all supposedly supporters of Suu Kyi's party. If the opposition leader herself isn't freed, the economic pain for Burma's 50 million people is set to worsen.

By Michael Shari in Singapore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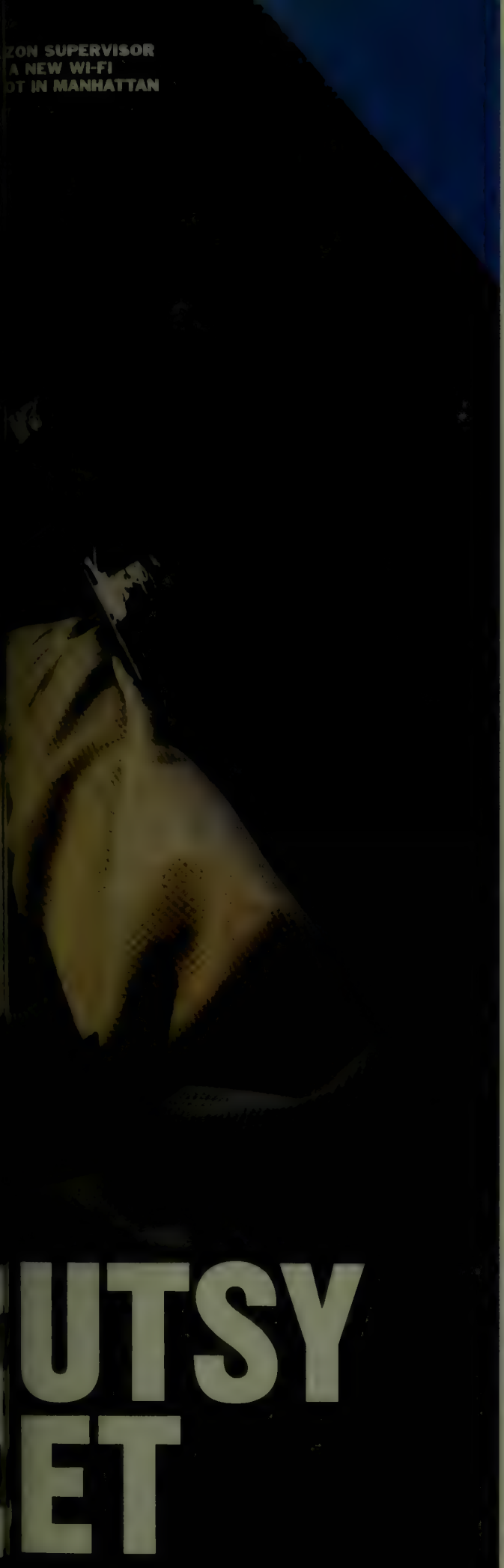


Will its massive rollout of fiber-optic cable–right to customers' homes and offices –keep it ahead of the pack?

By Steve Rosenbush

Ivan G. Seidenberg hardly looks like Old Man Telecom. The chief executive of Verizon Communications Inc. is only 56 and has the build and intensity of someone much younger. But sitting in his sun-filled, 39th-floor office in Midtown Manhattan, Seidenberg points out that he joined the company as a cable splicer's assistant in the Bronx when he was 19. He even keeps his cable splicer's shears, knife, and sheaf tucked away in his desk. "It's hard to believe, but I've been here for 37 years, more than one-third of this company's history," he says. "I feel an obligation to make sure this company is well positioned for the next 100 years."

Now Seidenberg is launching a series of sweeping initiatives to make good on his vow. From hardball pricing tactics that have knocked rivals back on their heels to a capital-spending war chest that's the largest in telecom, he's determined to transform what was once just another sleepy phone company into the pacesetter for the industry. "When you're the market leader," says Seidenberg, "part of your responsibility is to reinvent the market."

At the heart of this reinvention is the most ambitious deployment of new telecom technology in years. Verizon plans to roll out fiber-optic connections to every home and business in its 29-state territory over the next 10 to 15 years, a project that might reasonably be compared with the construction of the Roman aqueducts. It will cost $20 billion to $40 billion, depending on how fast equipment prices fall, and allow the lightning-fast transmission of everything from regular old phone service to high-definition TV. No competitor yet dares follow suit, fearing it could be their financial Waterloo. "We'll watch them closely and go to school on them if they have found something economic," says Ross Ireland, chief technology officer at SBC Communications Inc., the second-largest phone company after Verizon.

Info Tech

Seidenberg is being no less aggressive when it comes to the wireless technology that has consumers and companies equally abuzz—Wi-Fi. In an unprecedented move, Verizon is blanketing Manhattan with more than 1,000 Wi-Fi hotspots that will let any broadband subscriber near a Verizon telephone booth use a laptop to wirelessly tap the Net for the latest news, sports scores, or weather report. If the rollout goes well, Verizon will duplicate this wireless grid in other major cities. Next up: third-generation wireless service, known as 3G, which lets customers make speedy Net connections from their mobile phones. Verizon will begin to deploy 3G in September, at least three months before any of its major competitors. "The other guys will say they want to be the best follower. The guy on the frontier takes a lot of arrows, so they say, 'Let someone else roll out 3G and fiber-to-the-home.' Well, that someone else is Verizon," says Alex Peters, lead manager of the $200 mil-

JUSTIN LANE

lion Franklin Global Communications Fund, which bought an undisclosed number of the company's shares last year.

Verizon is leading the way with its pricing strategies, too. In March, the company became the first Bell to slice its broadband Internet service by 30%, to $35 a month. That's typically 10% to 20% cheaper than cable players such as AOL Time Warner Inc. and Comcast Corp., which have grabbed an early lead in broadband service. Even the musty long-distance business is getting a jolt of innovation: Earlier this year, Verizon became the first Bell to offer unlimited long-distance and local calls for one flat rate, typically $55 a month. Customers loved the idea, and Verizon quickly zoomed past Sprint Corp. to become the third-largest consumer long-distance player in the country. Now, every other Bell has introduced its own flat-rate service.

What's behind Seidenberg's sudden series of audacious moves? Two major reasons: competition from cable companies and the CEO's vision of his industry's future. The cable assault is most pressing because Comcast and its brethren are cutting into Verizon's cash-cow local-phone business and swiping most of the customers in broadband, the fastest-growing segment of telecom. To compete, Verizon plans to use its fiber-optic lines to offer Net access that's 20 times as fast as today's broadband—and bundle that with local phone service.

Just as important is Seidenberg's conviction that telecom as we know it is history. In its place will emerge what he calls a "broadband industry" that will use the new, superfast Net links and high-capacity networks to deliver video and voice communications services with all the extras, like software for security. If he's right, other companies will follow Verizon's lead and the communications industry will be remade. denberg thinks ubiquitous broadband will transform b swaths of the economy. High school students, for insta could download the video of a biology lecture they mis Doctors could use crystal-clear videoconferencing to exa patients in hard-to-reach rural areas. "The cable indu focuses on entertainment and games. The broadband indu will focus on education, health care, financial services, an sential government services," he says. "I think over the five to 10 years, you will see five, six, seven [segments o economy] reordering the way they think about provi services."

Over the long term, the strategy will put Verizon completely new businesses. Though video may not b primary focus, the company says that within five years i

SEIDENBERG AND HIS "WARRIORS"

The Verizon CEO is known for his ability to spot talent. "All of these people could be CEOs in their own right," he says.

Info Tech

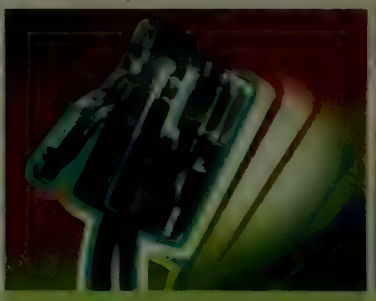
TELECOM'S NEW LEADER

Three years ago, Verizon looked like just another big phone company. But this year it has emerged as the industry pacesetter. Here's how:

OPTICS

Verizon is spending billions on blazingly fast optical lines to nearly every home and business in its territory over the next 10 to 15 years. This will challenge cable players in offering video, speedy Net access, and other services.

IMPACT Not only will the initiative result in new services for Verizon customers, but phone rivals will follow suit. That could spark a new round of capital investment.



BROADBAND

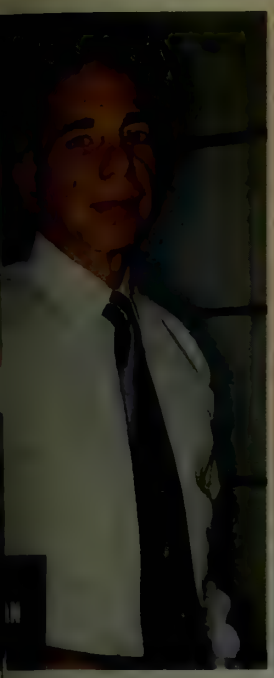
Cable-TV companies claim two-thirds of the 18 million U.S. broadband customers. In March, Verizon went on the attack, slashing the price of its rival DSL service by 30%, to $34.95. That's typically 10% to 20% cheaper than cable broadband.

IMPACT More customers will snap up broadband. That helps new bandwidth-gobbling Net services, like Apple's iTunes music service.

WI-FI

Verizon is blanketi Manhattan with 1, Wi-Fi hotspots, wh customers connect Net wirelessly with range of several hu feet. Verizon's DSL customers will get service for free.

IMPACT Customer the winners. They' get a bargain on W New York and may elsewhere. It will b for cable rivals to the deal.



ts to distribute video services, which could include TV gramming and movies on demand, so it can compete di- tly with cable companies. "I think it's terrific.... It could nitely work," says Sumner M. Redstone, chairman and CEO Viacom Inc., whose holdings include MTV Networks and amount Pictures, and where Seidenberg is a director. here are plenty of people, however, who think all that time nt up on the 39th floor has left Seidenberg a bit light-head- Can any company afford to do what Verizon is attempting? company says it will pump $12.5 billion to $13.5 billion into ital expenditures this year, the third-largest capital budg- n the world after DaimlerChrysler and General Electric Co. t's on top of the $3 billion a year it's paying in yearly in- st because of its $54 billion debt load. How can Verizon for all this? Its business is one of the great cash machines of Corporate America. The largest local-phone operator and the largest wireless company, Verizon generates about $22 billion a year in cash from operations. That's 50% more than SBC, twice as much as BellSouth, and nearly three times as much as AT&T. More than any company in the industry, Verizon can make enormous bets and pay for them out of its own pocket. Seidenberg expects to cover the fiber-optic initiative without raising the capital budget above the current level, while he continues to reduce the company's debt. "Funding is not an issue," he says.

Still, plenty of critics question whether Seidenberg is leading the industry in the right direction. SBC and Qwest Communications International ventured onto a different path when they announced partnerships with satellite-TV service EchoStar Communications on July 21. The deal will allow them to combine voice, video, and data on a single bill—sooner than Verizon and at a fraction of the cost. And rather than a massive fiber rollout to offer broadband Net service, SBC is focused on DSL, where it has a big lead on Verizon. Other industry experts think Verizon's plan may not make financial sense. "Frankly, I'm skeptical," says former Federal Communications Commission Chairman William E. Kennard, managing director of investment company Carlyle Group.

The skepticism stems in part from history. Verizon was formed from the merger of Nynex and Bell Atlantic in 1997 and the melding of the combined companies and GTE in 2000. The predecessor companies tried, and failed, several times in the 1990s to capitalize on the convergence of television and communications. Bell Atlantic and Nynex helped launch Tele-TV in 1994 to develop interactive-TV programming, but the project folded after several years. Bell Atlantic also announced a merger with cable-TV powerhouse Tele-Communications Inc. in 1994, only to see the deal fall apart a few months later.

Now Verizon faces cable companies that are spoiling for a fight. The cable industry has spent more than $75 billion since 1995 to upgrade their networks for high-definition TV, fast Internet access, and telephone service. The phone companies "have to make sizable investments to catch up," says David N. Watson, executive vice-president for marketing at Comcast, the nation's largest cable operator. "And we won't be standing still." In fact, Comcast and the other cable companies are hell-bent on torpedoing Seidenberg's plans by destroying Verizon's profits before it can use them to get into the video busi-

IRELESS DATA

ember, Verizon s will roll out neration (3G) ogy in Washington n Diego. This will s tap the Net from a cell r from a laptop at faster than a DSL ion.

Verizon will be market, pressing e Cingular to keep ustomers will get rvice for about the ice.

RESEARCH

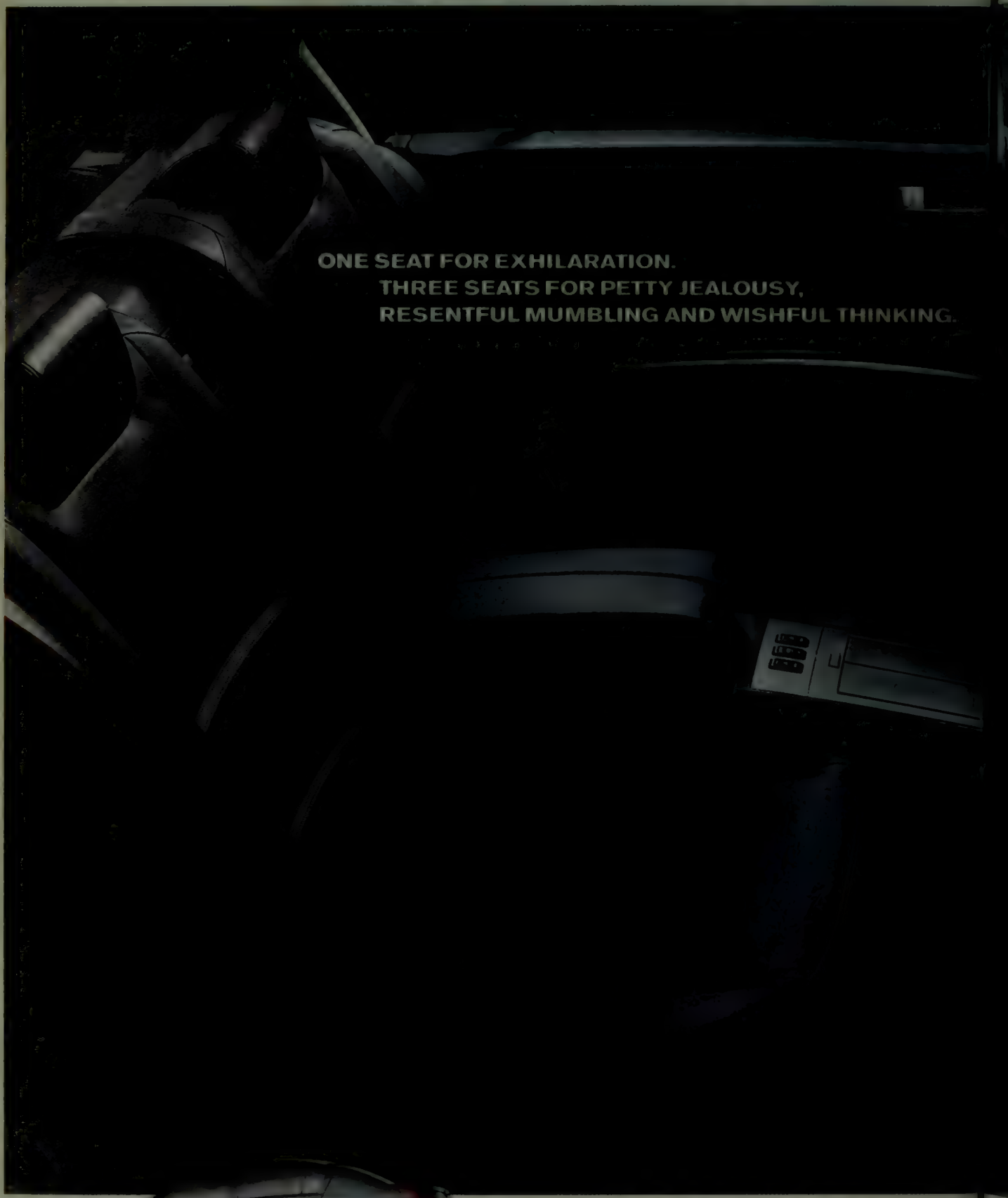
As others cut back, Verizon's scientists are focusing more on novel products. One example: the Digital Companion, which next year will let you log on to a Web page from anywhere to see calls as they come in to your home, so you can route them elsewhere.

IMPACT By going beyond basic phone service, the company hopes to build consumer loyalty and add new revenue streams.

LONG DISTANCE

In January, Verizon became the first Bell to introduce unlimited local and long-distance calling for a flat fee. And it has displaced Sprint as the third-largest consumer long-distance company.

IMPACT All of the other major local-phone companies have followed Verizon's lead in offering flat-rate phone-service packages. Now Verizon can compete on an equal basis with rivals such as AT&T.



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VERIZON'S OBSTACLE COURSE

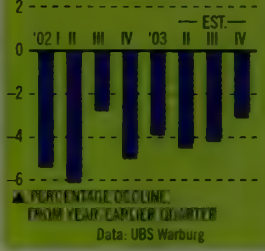
Its ambitious agenda won't be easy to achieve. Here are the main hurdles, and prospects for overcoming them:

PHONE BUSINESS

Revenue from Verizon's local-phone business declined 4.2% during the first quarter, as wireless rivals and resellers like AT&T ate into its business.

OUTLOOK The trend can't be reversed, but Verizon can slow the losses by offering bundled services.

LOSING LOCAL-PHONE REVENUES



Data: UBS Warburg

DEBT

Verizon has managed to cut debt to $54 billion from $64 billion, but that's still high relative to rivals. Its ratio of net debt to earnings is 1.6, compared with 0.8 for SBC and 1.1 for BellSouth.

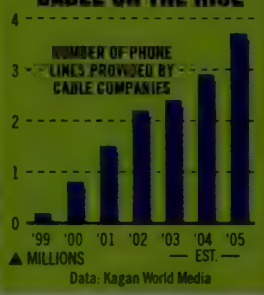
OUTLOOK While Verizon has plenty of cash to cover debt payments and other obligations, it will need to keep reducing its debt to free up cash for new investments. That may require the sale of some assets, such as its international holdings.

CABLE

Although cable companies have only 2% of the U.S. phone market, that will probably grow to 30% of the U.S. phone market over 10 years.

OUTLOOK Verizon's investments in fiber should make it more competitive because the technology will allow it to offer TV service.

CABLE ON THE RISE



Data: Kagan World Media

COSTS

With a big union workforce and lots of older technology, Verizon's cost structure is high- than its younger rivals'. Its 228,000 workers each generate $294,000 in revenues, among the lowest in the industry.

OUTLOOK Verizo is in contract talks with its unions and hopes to extract cost-saving concessior Talks are tense, however, and a strike is becoming a real possibility.

ness. Cable players are expected to nab 3.7 million phone lines nationwide by 2005, up from 2.2 million last year, according to market researcher Kagan World Media. That, along with competition from AT&T Corp. and wireless companies, caused Verizon to lose 3.7% of its local-phone lines in 2002.

The competitive threat is compounded by Verizon's labor situation. The company is locked in intense negotiations with its two main unions over a new contract for 75,000 of its 228,000 employees. Far apart over issues of health-care costs, work-rule flexibility, and organizing in the wireless unit, the two sides may very well be headed for a strike when the current contract expires on Aug. 2. Verizon has trained tens of thousands of managers to assume union duties should the talks fail. "There is no clear break. Sometimes you can see it in advance. This time, we can't," says George Kohl, director of research for the Communications Workers of America.

Info Tech

Verizon's labor issues won't disappear even if a strike is averted. More than half of its workers belong to a union, while rival cable companies are typically nonunion shops. Verizon has what it says are the highest costs in telecom, with union workers in New York earning an average salary of $62,000, plus overtime and benefits. More important, Verizon has less flexibility than competitors when it comes to laying people off or reassigning them to high-growth units. On July 11, a labor mediator in New York ordered Verizon to rehire 2,300 workers the company had thought it had the right to lay off. It quickly announced it would rehire an additional 1,100 workers who were making similar claims in mediation.

Asked about all the skepticism, the understated Seidenberg responds with a wry smile. "People that watch our industry tend to be skeptical when there's hard work involved, but we've shown the resolve to get up every morning and do what it takes," he says.

Seidenberg and other execs insist much has changed at Verizon since the miscues of the '90s. In February, the FCC changed the regulations so that Verizon and other Bells won't have to share their new networks with rivals at ernment-controlled prices. Although final details have y be released, the decision strengthens the business case building the networks. At the same time, the price of ro out fiber to homes and offices has dropped by 50% the past five years, and it will likely decline another over the next few. "This is not a trial. It's a deployme says Bruce S. Gordon, president of Verizon's consumer sion. "The decision has been made, and it will hap There's no going back."

If Seidenberg is right, he's positioning Verizon to thriv the coming decades. Short-term, the deterioration in the local-phone business probably will cancel out growth in services. Analyst Simon Flannery of Morgan Stanley pects revenues to stay flat at $67 billion this year while income declines 10%, to $7.5 billion, not including a $3 bi noncash charge for an accounting change and a write-d from international operations. Profits could even shrink a in 2004, to $7.2 billion. After that, Verizon's prospects better. As broadband services are rolled out to more o customers, Flannery estimates that the company's rever will hit $70 billion in 2005 and net income will recover to billion. "They are definitely the industry's future," says B Adamik, chief executive of market researcher Yankee Gr

Leave it to Seidenberg to do what others think impossi The son of an air-conditioning repairman, he grew up in working-class Gun Hill section of the Bronx. If he had po tial for greatness, it was well hidden. Without the money college, he started working for New York Telephone spli cables in 1966. He was quickly drafted into the U.S. A and wounded in Vietnam. After he returned to his old ployer in 1968, his raw determination emerged. With his c pany helping to foot the bill, he earned a BA in mathema from Lehman College, of the City University of New Y and an MBA at Pace University. He married his high sc sweetheart, Phyllis, and they now have two children. Du this time, he spent 12 straight years going to night schoo

He worked hard on the job, too. As the youngest perso

NOW DO I HAVE YOUR ATTENTION?
I AM YOUR IDEA
I AM YOUR IDEA
M
IDEA
not how many ideas you have. It's how many you make
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a work team laying cables at Co-op City in the Bronx, Ike, as he was called at the time, would remeasure the cable lines of other workers to see if they were the right length. Perhaps most surprising, he did it without getting throttled by more-senior workers. How? He never tried to take credit for the extra work from supervisors. He simply told the other workers so they could correct any errors as a team. Plus, he was a likable guy who played in the regular lunchtime football games. Seidenberg worked in operations and engineering before moving to Washington to handle regulatory affairs. In 1995, he became chairman and CEO of Nynex Corp.

It could have been a brief, shining moment of glory. When the local-telephone industry was deregulated in 1996, Nynex looked like takeover bait: too small to determine its own fate. Still, Seidenberg figured out a way to get the necessary scale by cutting savvy deals and sharing the spotlight. First, after the Bell Atlantic merger, he let Bell Atlantic Corp. CEO Raymond W. Smith run the combined companies for a couple of years before taking over. Then he waited his turn while GTE Corp. CEO Charles R. Lee ran the show, taking full control only after Lee stepped down as co-CEO last year, at the age of 62. "He's a master boardroom player," says Kennard.

Even now, Seidenberg is eager to let his lieutenants take the limelight. He often has Vice-Chairman Lawrence T. Babbio Jr., who runs the traditional phone business, and Verizon Wireless Services CEO Dennis F. Strigl represent the company in public forums. "All of these people could be CEOs in their own right. They are warriors, and they are on a mission," says Seidenberg. Yet they profess fierce loyalty to him and Verizon, which has been an island of stability in a churning sea.

The commander will need all the warriors he can get. Within two years, the cable-TV companies are expected to be in the phone business big time. They already have 15% of the market in a handful of Verizon neighborhoods where they offer phone service. Cable companies like Comcast, Cablevision Systems, and Cox Communications are planning to expand their phone operations in 2004 using Internet technology that's cheaper and packed with features like inexpensive second and third phone lines. At the current pace, the cable companies will probably have 30% of the phone market over the next decade, says telecom analyst John Hodulik of UBS.

The fiber strategy will help Verizon defend itself. By offering TV, superfast Web access, and feature-rich Internet-based phone services, Verizon could reduce potential customer churn by 50%, Hodulik estimates. Assuming fiber ployed, he thinks the company will have 2007 net inco $7.9 billion on revenues of $79.7 billion. Those numbe 2.5% and 5.7% higher than his forecasts before the strategy was outlined.

Although these are the early days, high-speed fibe nections are proving popular with consumers. Verizo ready is installing fiber in Brambleton, a planned comm in Loudoun County, Va. Only 200 homes have been bu far, but that will grow to 6,000. Liz and Steve Lev among the early adopters. The high-speed Net conne helps them stay in touch with neighbors over the comm Web site, and Liz Levy uses it to maintain a Web site f stationery business. They get pitched by satellite-TV c nies all the time, but they won't switch. "It works well, and I like getting all the services from a single c ny," she says.

Still, there's no guarantee that Seidenberg's broa vision will become a reality. No company has atten what he is doing on such a massive scale, and even sm initiatives have shown mixed results. Construction of a network in Eugene, Ore., was cut back because the nomics of the effort didn't pan out. The city had orig planned to extend its optical links into homes and busi es, but it canceled the plan in March, 2002, as the eco soured. "We just couldn't make the numbers work," Lance Robertson, communications coordinator for the Eu Water & Electric Board.

Whether the numbers work for Verizon will depend costs for the new network. Installing a fiber-optic line home or business has dropped to about $2,000 today more than $4,000 five years ago, according to marke searcher Render, Vanderslice & Associates. The firm ex that will fall another 50%, to $1,000, in the next five yea though that will depend on how quickly Verizon and the buy equipment. Doreen Toben, Verizon's chief financial o says costs have just now come down enough for the init to make financial sense. It should be profitable if the com expense per line comes in between $1,200 and $1,800.

Verizon has a card up its sleeve. About 45% of its tomers are wired via telephone poles and other above-g connections, according to Verizon Chief Technology O Mark Wegleitner. That's compared to 32% for BellSouth for SBC, and 13% for Qwest. Why is that key? It's as mu 30% cheaper to upgrade a line on a phone pole than it upgrade one buried beneath a sidewalk or someone's l

Despite the challenges, Seidenberg has a track record

IVAN G. SEIDENBERG

The 37-year company veteran (right, as Nynex CEO with Bell Atlantic CEO Ray Smith) has gone from cable splicing to the top job.

BORN Dec. 10, 1946, in New York.

UPBRINGING Son of a Bronx air-conditioner repairman.

EDUCATION BA, Lehman College, of the City University of New York,1972; MBA, Pace University, 1980.

CAREER Joined New York Telephone in 1966 as a cable splicer's assistant after high school. Left to serve a tour of duty in Vietnam as a tail gunner. Returned to the phone company in 1968; earned a college degree in math by attending night school. Worked as an engineer, chief lobbyist, and president of Nynex. He merged Nynex with Bell Atlantic in 1997 and then formed Verizon in 2000 by combining with GTE. Became sole CEO of Verizon in 2002.

STYLE Patient and self-effacing. Likes to shine spotlight on his team. A Nynex merged with Bell Atlantic and later with GTE, he let his counterparts have the CEO title for a couple years before taking over. "He's a mas boardroom player," says former FCC chairman Bi Kennard.

FAMILY He and his wife Phyllis, have two childre They live in Manhattan.

OTHER INTERESTS Lov sports; an avid runner.

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tient investing that pays off in the end. Consider the wireless business, 45%-owned by Vodafone Group PLC. In recent years, it invested more than its rivals and has reaped the reward. Today, with 33 million subscribers, it's far larger than No. 2 Cingular, a joint venture of BellSouth Corp. and SBC. And it's ahead on many financial metrics, from revenue and earnings growth to profitability. "We're trying to replicate wireless' successful model in other parts of the company, but it takes patience," says Babbio.

Verizon's wireless data plans should keep that growth engine humming. Beginning this September, it will introduce wireless systems in Washington and San Diego that let customers download data at peak speeds of 2.4 megabits a second. That's about five times faster than a DSL connection. While rivals are expected to deploy comparable technology, Verizon is ahead of the curve. Competitors won't roll out the technology until 2004 or 2005. By getting to market first, Verizon expects to maintain its above-average growth.

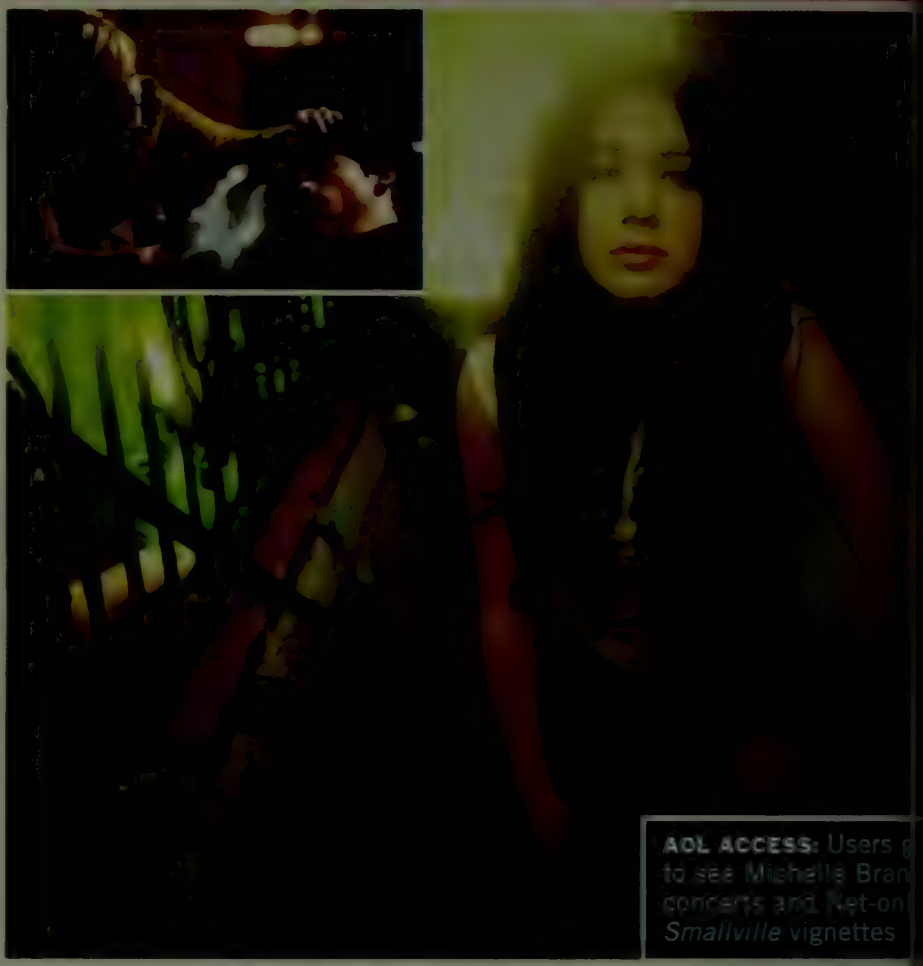
Rivals are skeptical. "The real question is, is the market ready for it," says William E. Clift, Cingular's chief technical officer. Seidenberg thinks all of these investments will create something of lasting importance and have a positive impact on the overall economy. "As broadband becomes more pervasive over the next three or four years, all the 'excess capacity' in long distance will get absorbed," Seidenberg says. "Microsoft or IBM would never say there's overcapacity. They envision a world in which you always need more capacity to handle all the things they can make. The problem is, we don't have that capacity where it needs to be...in the home and office."

It will require near-perfect execution. But Seidenberg performs well under pressure. One afternoon in 1969, the young cable splicer and his buddies took a break for a game of touch football at Ferry Point Park in the Bronx. Pat LaScala, a cable splicer's assistant who had played high school football, told Seidenberg to go out for a pass as far as he could. "He ran right into a tree and got some big welt on his eye," LaScala recalled. "But he caught the ball." Today, he needs that poise more than ever. This time, it's no game.

With Tom Lowry in New York, Roger O. Crockett in Chicago, and Irene M. Kunii in Tokyo

BusinessWeek online

For highlights of *BusinessWeek*'s interview with Verizon CEO Ivan Seidenberg, go to www.businessweek.com/magazine/extra.htm



AOL ACCESS: Users g to see Michelle Bran concerts and Net-on *Smallville* vignettes

INTERNET

AOL: SCRAMBLING TO HALT THE EXODUS

Its 9.0 software is a step up, but content is key to its surviv

America Online is in a fight for its life, and lately it has looked like it's losing. After dominating the market for Internet access for nearly a decade, AOL has seen its 25 million U.S. members begin to defect in droves to cut-rate dial-up competitors and to broadband rivals who are beginning to slash their monthly fees in a burgeoning price war. In the second quarter, 846,000 AOL subscribers departed—the largest quarterly drop ever.

Now, AOL is launching a new effort to stem the tide. On July 31, the company will release the most significant upgrade to its software in years, certainly since the disastrous merger with Time Warner was unveiled in January, 2000. AOL 9.0 will boast over 100 new features, including faster downloads, free e-mail age on AOL's computers, and an easy for subscribers to keep blogs, or journals. Subscribers even will be a plug a phone into their computer make free phone calls via AOL's ins messaging service.

Most important, AOL 9.0 will b doorway to a brand-new world of content. It's designed to help subsc tap into a growing number of video, and magazine offerings from Warner. They include live online formances, like recent concerts b Foo Fighters and Michelle Branch, are tripling to 15 a week from 5. W Bros. television is making Net vignettes and extras from TV show *Smallville* for the first time ever

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9.0 also will bundle content—such as ABC News and *People* magazine—that would cost $130 if users bought it à la carte on the Web. "9.0 is the biggest leap at the company from one release to the next," says CEO Jonathan F. Miller, who joined AOL last August.

It had better be. AOL is a narrowband company in what's rapidly becoming a broadband world. Almost all of its $9 billion in revenues come from subscribers who typically pay $23.90 a month to log on to the Net via their phone lines. The number of these so-called narrowband subscribers is expected to slide 6% this year, to 45 million U.S. households, and broadband subscribers get its service now, a big comedown for a company that once had 50% of the Net-access market. AOL 9.0 is a step forward, but much better content is needed to justify $15 a month. Richard Greenfield of Fulcrum Global Partners, the only analyst who has made such projections, thinks the company can improve its content enough to boost its broadband market share to 25% of the expected 40 million subscribers in 2006, while retaining about half its narrowband base. Under such optimistic assumptions, AOL would have about $5 billion in 2006 revenues, down from Greenfield's estimate of $8.7 billion

for thawing relations with Time Wa execs. After arriving from Bertels last year, the former music exec st working with Warner Music Grou build innovative, cooperative vent What resulted was AOL's First L series, which has premiered 50 new by artists such as Christina Agu and Sessions@AOL, which has show 300 artists in live online performan

These days, Conroy is using his can-we-do-for-you approach elsewhe Time Warner. The movie business natural. AOL is promoting New Line ema Inc.'s low-profile teen flick *H Deal* this summer—and it got excl

AOL TRIES TO CLAW ITS WAY BACK

AOL is at its battle stations. The world's largest online service is losing customers to broadband providers and cut-rate dial-up. Here's how it plans to stem the tide:

THE FOO FIGHTERS PLAYED ONLINE FOR AOL

IMPROVE SOFTWARE

In late July, the company will launch AOL 9.0. With over 100 new features, it's a leap forward. It offers firewalls, antivirus protections, buffed-up spam filters, faster downloading, storage of e-mail on AOL servers, and phone calling via instant messaging.

PROVIDE EXCLUSIVE CONTENT

Warner Bros. is producing extra vignettes of shows such as *Smallville* to run exclusively on AOL. Time Inc. magazines, including *People*, are available online only to AOL and magazine subscribers. And Warner Music Group provides exclusive online performances by artists such as Michelle Branch.

CUSTOMIZE THE SERVICE

This fall, AOL will launc special versions for kids and teens. Kids will log to an AOL that immerse them into one of six worlds, including the jungle or outer space. A also is starting a Spanis language version of 9.0.

IMPACT?

Not that great. AOL 9.0's features are impressive, but rivals like MSN can copy most of them easily.

Significant. Content is AOL's best chance at persuading subscribers to pay for its service as they move to broadband.

Not clear. AOL hasn't shown demos yet. If it c tap Warner Bros. to devel say, a Looney Tunes wor with video clips, this co have potential.

will keep falling for the foreseeable future, according to Goldman, Sachs & Co. Meantime, broadband subscribers are projected to increase nearly 40% this year, to 25 million households, and surpass narrowband subscribers in 2006.

Up until now, AOL's strategy for dealing with this has looked like a quick route to oblivion. The company has been trying to persuade people to pay $14.95 a month for its service on top of the $30 to $50 a month they pay the phone or cable company for broadband connections. But AOL has offered little extra for the fee, and only an estimated 1.4 million members have bitten so far. A package deal for broadband and AOL brought 800,000 more subscribers. AOL 9.0 is supposed to give consumers more bang for the buck.

Will it work? AOL will never regain the dominance it had in narrowband in the broadband market. Only 10% of for this year. Without more compelling content, the more likely scenario is that AOL's share of broadband subscribers will stay at about 10%. Then AOL's revenues will plummet to less than $3 billion by 2006, and its cash flow will be crunched.

Pressure will come from MSN and Yahoo! Inc., which sell their broadband services cheaper. No. 2 rival MSN goes for $9.95 a month on top of broadband. In May, MSN started selling its service with Verizon Communication's DSL connections for as low as $29.95 a month. Yahoo comes with SBC Communications Inc.'s broadband service for $39.95 a month. "Ultimately, everyone is concerned about their pocketbook," says Lisa A. Gurry, MSN's group product manager.

Rather than cut prices, Kevin Conroy, the COO at AOL's broadband unit, is running hard to add exclusive content. Conroy is one of the people most responsible

previews of Warner's *Terminator 3* buster. "A sister company that offe posure [to 25 million members] is a leg up," says Barry M. Meyer, C Warner Brothers Entertainment In

Time Warner television is takin vantage of that exposure for the time. In April, Warner TV's *Smal* launched online vignettes starrin show's character Chloe Sullivan to the buzz between episodes. The *Chronicles* is viewed 200,000 times ly. Likewise, Turner Networks has t its rights to the NBA, NASCAR, an British Open into 3- to 4-minute be the-scenes video clips, including streaming of Tiger Woods' rounds.

AOL's latest efforts are encoura But it'll need to keep developing content to ensure its place in the b band future.

By Catherine Yang in Dulles

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People issues are complex. Managing them doesn't have to be. Hewitt

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IBM®

Ming Tsai, IBM business strategist, retail industry

The waggly bee dance and the responsive enterprise.

Upon arriving back at the hive, a bee with pollen-coated legs does a waggly dance for her fellow bees. The thorax motions are actually a map drawn in the air, entomologists have suggested, indicating both the direction and the distance of the pollen source.

This is the kind of "sense-and-respond" behavior that defines on demand business — the kind that most companies can only dream about.

A sense-and-respond retail environment, for instance, would know every time its best customers entered the store. It would be able to respond to what each valued customer was shopping for that day and suggest appropriate cross- and up-sells. Products would be in stock, promotions would be relevant, sales associates would be experts, checkout would be instantaneous.

This is on demand business, waggling to show you where the money is.

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McDonald's
intel
Enjoy
Trade-mar
COFFEE

BRANDS

N AN AGE OF ANTI-AMERICANISM

BusinessWeek/Interbrand's annual ranking of the world's most valuable brands shows that American labels are still potent

ark Young Hoon of Seoul was quick to clench his fist and yell slogans against George W. Bush earlier this year in a giant rally denouncing the U.S. President's n policy on North Korea. But that n't mean the 33-year-old computer neer is willing to loosen his grip on avorite American coffee or cola. ing for political independence from J.S. is one thing, and liking Amer- brands is another," he says. "Of e I like IBM, Dell, Microsoft, Star- s, and Coke."

ckily for the stewards of America's st brands, plenty of other con- rs around the world are making ame distinctions. America's go-it- attitude in recent years, which shaped its position on everything environmental issues to Iraq, has ed plenty of anti-U.S. sentiment. r, however, that antipathy is not g over into a widespread rejection S. hamburgers or packaged goods. eni students were out burning the rican flag, chanting 'kill the Amer- '" in early March, notes Jack ti, CEO of the Motion Picture As- tion of America. "As soon as the ers opened at 7 p.m., bingo, they all in there." Indeed, overseas ffice receipts for American movies been cresting at near-record highs year despite mounting anger st the country in which the films produced.

Whatever the world thinks of the U.S. these days, American labels dominate this year's annual *BusinessWeek*/Interbrand Corp. ranking of the 100 most valuable global brands. U.S. brands claimed 62 places, including 8 of the top 10 spots. The ranking is based on a detailed analysis of how much of each product's sales are driven by the brand name, weighted for such other factors as market leadership, stability, and the ability to cross national borders.

The World's 10 Most Valuable Brands

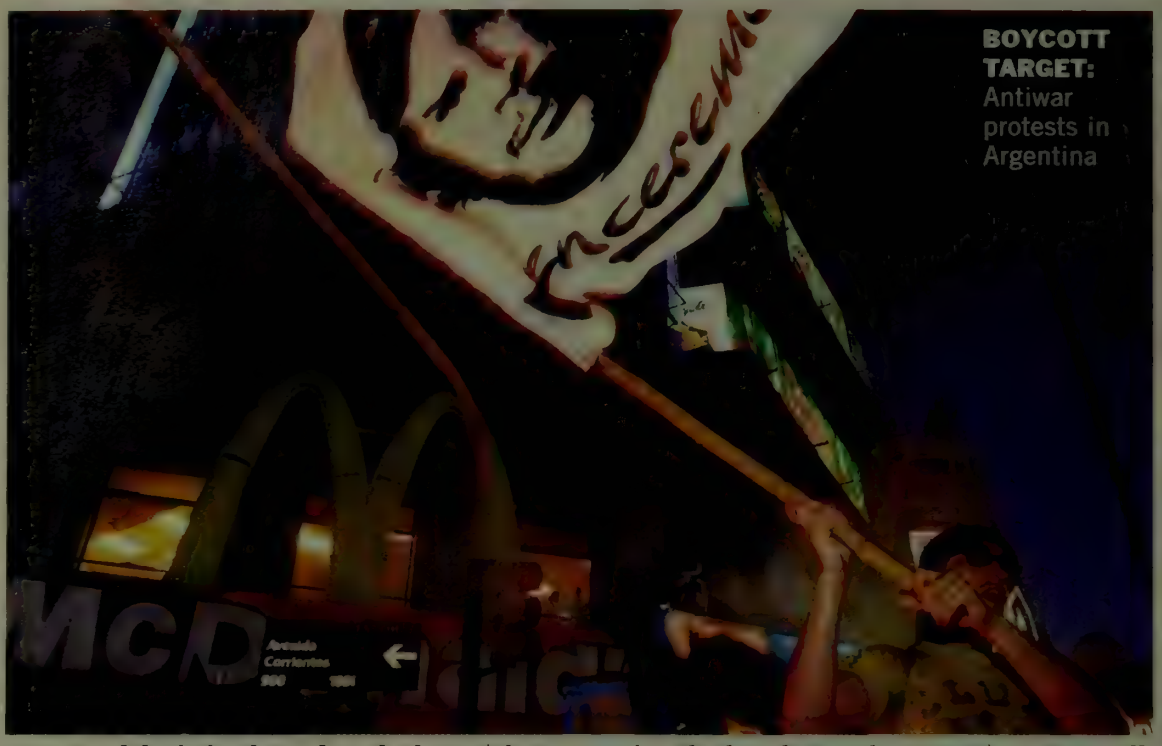
RANK	BRAND	2003 BRAND VALUE BILLIONS
1	COCA-COLA	$70.45
2	MICROSOFT	65.17
3	IBM	51.77
4	GE	42.34
5	INTEL	31.11
6	NOKIA	29.44
7	DISNEY	28.04
8	McDONALD'S	24.70
9	MARLBORO	22.18
10	MERCEDES	21.37

Data: Interbrand Corp., J.P. Morgan Chase & Co., Citigroup, Morgan Stanley

Just because American brands dominate doesn't mean foreign brands aren't also moving up the ranks. Samsung Electronics, SAP, L'Oréal, and Toyota posted some of the biggest gains on the list. And consumers were clearly paying attention to current events. Another year of corporate scandals and mediocre stock market returns chipped away at the value of such brands as JPMorgan, Merrill Lynch, and Morgan Stanley.

Those that have suffered the steepest valuation declines—such as Ford, down 16%, to $17.1 billion, or Kodak, down 19%, to $7.8 billion—are less the victims of a tense political climate than of stumbles under the weight of quality issues, mistargeted products, or other fundamental business problems. Some, such as Levi's and McDonald's, are racking up higher sales growth overseas than at home. The names that dominate the roster, such as top-ranked Coke and No. 2 Microsoft, are global players that rise above the noise of political dissent to appeal to consumers everywhere.

What is it, exactly, that's keeping U.S. brands aloft? Credit a combination of smart brand management and sheer luck. That American brands are born and nurtured in the world's largest and most eclectic economy confers a huge advantage. By the time they venture overseas, issues of quality, consis-



BOYCOTT TARGET: Antiwar protests in Argentina

CAFE SOCIETY: In Lebanon

tency, and logistics have largely been resolved. And many brands have been in the global marketplace for so long that few consumers can say with any certainty where they originated.

At the same time, American marketers have worked hard to imbue their products with American values that are still attractive overseas. "I think the core values of Levi's—democracy, freedom, independence—certainly are viewed as the best of America and its virtues," says Levi Strauss & Co. CEO Philip A. Marineau, whose brand still struggles at home but is coveted in markets such as Asia.

Far more important, marketers have learned to weave their products into the local culture by hiring local managers and adapting everything from packaging to serving sizes to flavors to the local market. Thus, McDonald's Corp. sells aloo tikka in Bombay, teriyaki burgers in Tokyo, the flatbread McArabia in Amman, and kosher McNuggets in Tel Aviv. Despite continued tensions in the Middle East, that's where the company saw some of its strongest sales growth over the past year. Many brands also try to cement their local ties by taking on ambitious community-service programs such as Coca-Cola Co.'s educational grants made through the Palestinian Authority and donations to environmental causes in Spain.

For a taste of how U.S. brands are sold, look at Pepsi in India. It's still the same soda pop that flows in America, but with a distinctly Indian twist. PepsiCo has nurtured a homegrown image by sponsoring the hugely popular sport of cricket, using local celebrities in ads and filling its senior management slots with Indian talent. It has also taken community involvement to another level with such ventures as growing tomatoes and exporting chili paste with the state government of Punjab. Pepsi's local slogan, *Yeh Dil Maange More!* (This Heart Wants More!), is so popular that an Indian army major famously shouted it into the snowy Himalayan valleys after a key victory against the Pakistanis in the 1998 Kargil war. No wonder a three-day foreign-product boycott in the Communist state of Kerala barely made a dent in the soft drink's sales. And it's no surprise that the Pepsi brand has jumped 6% in value, to $11.8 billion, this year.

For other brands, however, victory overseas means adhering strictly to the formulas that propelled them to the top in the U.S. Take Dell Inc., which added 12% in brand value this year, to $10.4 billion. It has strived to replicate exactly the model that made it famous at home. That means mass customization, direct-to-the-buyer sales, and fast turnaround. The temptation to adapt to local conditions or lessen standards may be great, especially as European buyers have been slow to shop via the Internet and the less efficient payment practices of China mean buyers wait days before their Dell PC is shipped. But being a bulldog can pay off. Today, Dell is the la foreign seller of PCs in China and i ing strong in Europe.

Some brands have overcome an American prejudice by appealin shared values. Nike Inc.'s "Just message of individual empowermen athletic achievement plays as w Jakarta as it does in Jefferson City emotional appeal has proven espe powerful in regions such as We Europe and Asia, where Nike is ra up the greatest sales growth.

Not every brand, of course, found it easy to navigate over Some misread demand; others get up on cultural differences. And a ber simply become too stretche maintain the quality and service drove them to the top at home. bucks Corp. saw its brand gain 9

Winners

What tech slump? Suppliers of consumer electronics (Samsung), personal computers (Dell), printers (HP), and business software (SAP) were among the biggest-gaining brands.

RANK	BRAND	2003 BRAND VALUE (BILLIONS)	2002 BRAND VALUE (BILLIONS)	PERC CHA
25	SAMSUNG	$10.85	$8.31	+3
12	HEWLETT-PACKARD	19.86	16.78	+1
35	SAP	7.71	6.78	+1
29	DELL	10.37	9.24	+1
47	L'OREAL	5.60	5.08	+1

Data: Interbrand Corp., J. P. Morgan Chase & Co., Citigroup, Morgan St

GLOBAL POWER **While some brands are emblematic of the U.S., many consumers distinguish between politics and products**

WIDE REACH: Zimbabwe village

to $2.1 billion, this year, but that
rgely on the strength of double-
gains in the U.S., where sales of
thing from its compilation CDs to
d Frappuccino are booming. "The
of the brand has gone well be-
a cup of coffee," says Chairman
rd D. Schultz. Its 1,600 overseas
are net money losers, however.
sts attribute the losses to high
p costs, stiff competition, and less
st in the so-called Starbucks ex-
ce. Schultz blames the setbacks
nporary growth pains and a bad
ny.

problems have been far worse
S. carmakers. Not only are they
traction in foreign markets but
ome turf has long since been in-
by Asian and European com-
s offering higher quality and bet-
ter design, often at lower prices. Toyota gained 7% in brand value, surpassing its American rivals at $20.8 billion. Over the past 12 months, the Toyota brand has gained $1.3 billion in value, while Ford has lost $3.3 billion. The next big auto name on the list: Honda, which increased 4%, to $15.6 billion. The brands of General Motors and Chrysler, which are less global, can't even crack the top 100.

As the car rankings show, a brand's popularity is only partly a result of careful grooming. Quality can't be faked, and many shoppers outside the U.S. really only care about a good deal. "If something is useful we buy it, whether it's made in the U.S., China, or elsewhere," notes student Heather Kam, while sipping a Caffè Mocha in a Hong Kong Starbucks.

There's another reason consumers overseas can rage against U.S. foreign policy one minute and relax with a Bud the next. Some products have become so widespread that many people are only vaguely aware of their countries of origin. Ahmad Tarouat, a 23-year-old Parisian salesman, may insist that he will never ingest a Big Mac because "McDonald's stands for American imperialism," but he seems oblivious to the origin of the Nike sneakers on his feet or the pack of Marlboro Lights in his hands.

He's not alone. In surveys, consumers routinely guess that Heineken is German (it's really Dutch) and that Nokia is Japanese (it's Finnish). Nestlé, a Swiss brand, found itself on some Arab boycott lists of American products during the Iraq war. And few know that Häagen-Dazs and Estée Lauder were actually born in the USA. Even where consumers can correctly identify the national origin of a multinational brand, they are more inclined to think of it as global rather than American or Japanese, according to research by RoperASW.

U.S. corporations know that it takes more than translated slogans to win over a local population. As Jeffrey R. Immelt, chairman and CEO of General Electric Co., has noted: "We are a global company, [so] we want to present a global face to our customers." For Immelt, that has meant pushing more diversity through the ranks and, where possible, putting foreign talent into key management slots—and not just in their home countries. GE has watched its brand value increase 2% this year, to $42.3 billion, despite a tough economy.

Another area is getting increasing attention from American brand owners: the need to be perceived as responsible global citizens. That can mean everything from giving funding to rural schools, as Coca-Cola has done, to plowing resources into fixing environmental problems. True, established companies have long done that at home. But many are infamous for bad behavior abroad, from substandard conditions in factories to landscapes denuded by manufacturing.

In a global village, that kind of bad publicity anywhere can erode the value of a brand. Sexist ads in China can be transmitted to the West with a mouse-click. A grassroots complaint can garner a global audience if it's directed at a big name. That means, for example, that Nike's labor practices in developing countries can become an issue for consumers around the world.

The world is a fast-changing and fickle place where big names can quickly and sometimes irrevocably slide in favor. New competitors or louder anti-Americanism may yet send the value of American brands plunging. But so far they are still finding ways to connect with consumers everywhere. In the end, the most effective tactics are surprisingly simple. Take a look at one of Coke's hit commercials this year, which centers around a guitarist on a subway playing a melancholy tune until a kid hands him a Coke. After a long slug, he launches into a remixed version of the old mambo tune *Chihuahua* and soon has everyone on the subway chanting "Chihuahua!" Sure, it was made in Spain. But when Coke aired it in other parts of Europe, it found commuters there were chanting in unison, too.

By Gerry Khermouch and Diane Brady in New York, with Stanley Holmes in Seattle, Moon Ihlwan in Seoul, Manjeet Kripalani in Bombay, Jennifer Picard in Paris, and bureau reports

Losers

me long-entrenched players continued to
ose ground in financial data (Reuters),
tography (Kodak), automobiles (Ford), and
less communication (Ericsson) to nimbler,
more innovative competitors.

BRAND	2003 BRAND VALUE BILLIONS	2002 BRAND VALUE BILLIONS	PERCENT CHANGE
REUTERS	$3.30	$4.61	–28%
KODAK	7.83	9.67	–19
FORD	17.07	20.40	–16
PIZZA HUT	5.31	6.05	–12
ERICSSON	3.15	3.59	–12

nterbrand Corp., J.P. Morgan Chase & Co., Citigroup, Morgan Stanley

THE 100 TOP BRANDS

Here's how we calculate the power in a name

To rank the world's 100 most valuable global brands, we set three hurdles that all contenders have to meet to merit consideration. First, they must have brand values greater than $1 billion. They also have to be global in nature, meaning they must derive at least a third of their sales from outside their home countries and have significant distribution throughout the Americas, Europe, and Asia. Finally, they must have publicly available marketing and financial data. That excluded some big brands, such as Visa International, the BBC, and Mars.

How do you place a value on a brand? Some attempts rely on little more than opinion polls or ad spending. *BusinessWeek* selected Interbrand's method because it values brands the same way analysts value other assets: on the basis of how much they're likely to earn in the future. Those projected profits are then discounted to a present value based on how risky the projected earnings are—that is, the likelihood that they will, in fact, materialize.

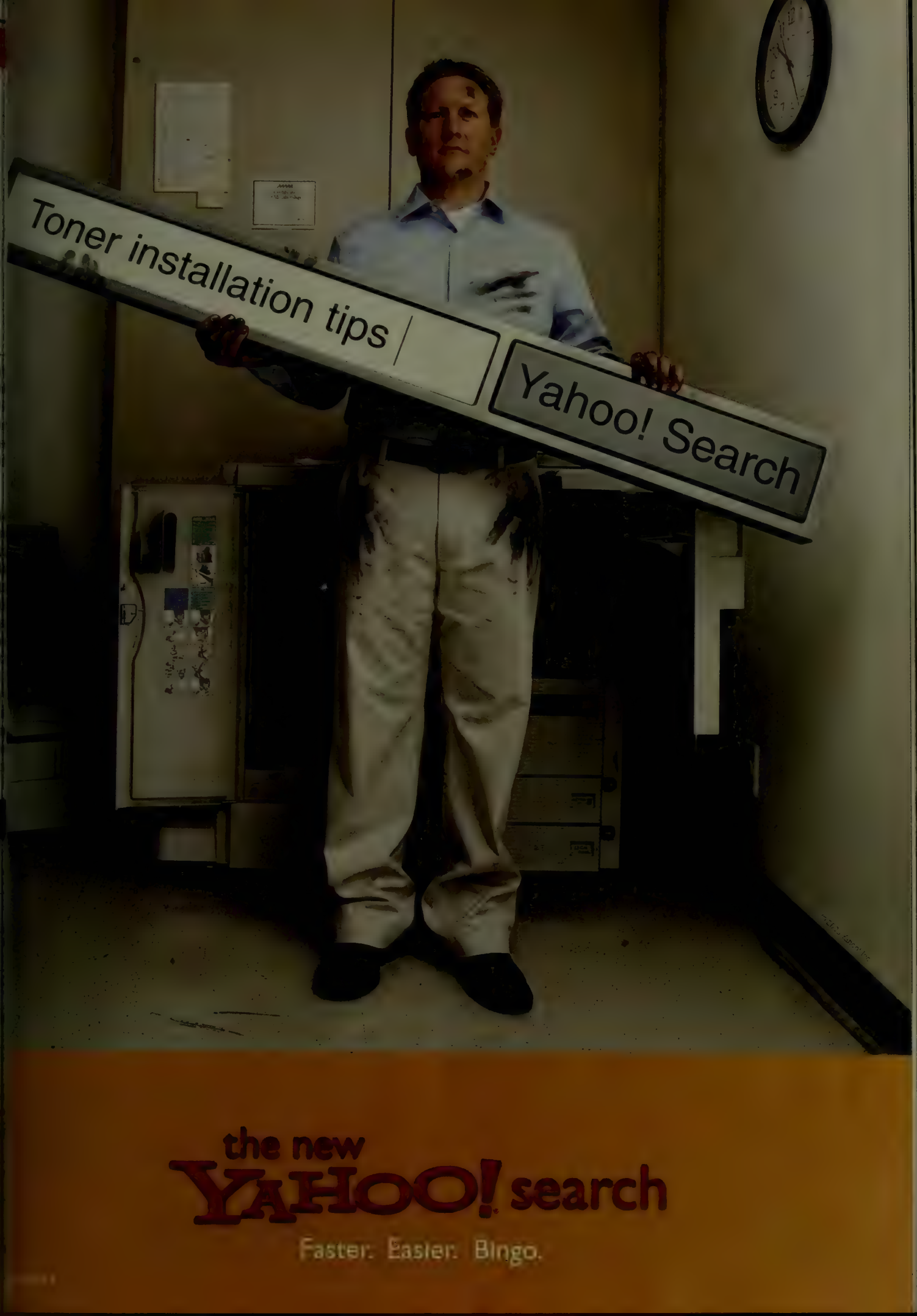
To start the process, Interbrand first figures out what the brand's overall sales are. (The brand may be almost the entire company, as in the case of McDonald's Corp. For others, such as Marlboro, it may be just a portion.) Next, with the help of analysts from J.P. Morgan Chase & Co., Citigroup, and Morgan Stanley, Interbrand projects net earnings for the brand. It then deducts a charge for the cost of owning the tangible assets, on the theory that whatever income is generated beyond that cost is due to intangible factors. This is the economic value added by things like patents, customer lists, and, of course, the brand.

The next step is to winnow the earnings generated by the brand from the earnings generated by other in
bles. For example, are people
Shell gasoline because of the
name or because the gas station
veniently located? Interbrand use
ket research and interviews with
try executives to sift through
variables.

The final phase is to analyz
strength of the brand to figure o
risky those future brand earning
To calculate the brand's streng
terbrand looks at seven factors,
ing the brand's market leadersh
stability, and its ability to cros
graphic and cultural borders. Th
analysis produces a discount rate
applied to the brand earnings t
up with a net present value. *Bu
Week* and Interbrand believe th
ure comes closest to representi
true economic value of that comp
ray of forces that make up a bra

The Global Brand Scoreboard

RANK	2003 BRAND VALUE $BILLIONS	2002 BRAND VALUE $BILLIONS	PERCENT CHANGE	COUNTRY OF OWNERSHIP	DESCRIPTION
1 COCA-COLA	70.45	69.64	+1%	U.S.	New variations such as Vanilla Coke and a lemon-flavored diet drink helped the soft-drink icon remain bubbly.
2 MICROSOFT	65.17	64.09	+2	U.S.	The software giant shifted its advertising to build the brand, not just products, at a time when most rivals were suffering.
3 IBM	51.77	51.19	+1	U.S.	Big Blue gained recognition in new markets, partly thanks to an $80 million marketing campaign pushing e-business on demand.
4 GE	42.34	41.31	+2	U.S.	Getting double-digit growth is harder, but in tough times, the brand Edison built held its own.
5 INTEL	31.11	30.86	+1	U.S.	With Intel Inside and Wi-Fi out to take over the world, the chipmake Centrino wireless notebook package delivered a powerful punch.
6 NOKIA	29.44	29.97	–2	Finland	Still the world's leading mobile-phone maker, Nokia faced stiff chall from fast-riser Samsung and a growing crop of operator-branded pho
7 DISNEY	28.04	29.26	–4	U.S.	Not the Happiest Place on Earth as Disney Stores were up for sale, overhauled prime time, and travel woes sapped theme parks.
8 McDONALD'S	24.70	26.38	–6	U.S.	Mixed-up orders and dirty restaurants hurt the brand. Now business covering somewhat behind a renewed focus on service and salads.
9 MARLBORO	22.18	24.15	–8	U.S.	Under siege from smoking bans and lawsuits, the Marlboro Man was looking like a fugitive.
10 MERCEDES	21.37	21.01	+2	Germany	The luxury auto maker crafts the sumptuous sedans the rich and fam love to buy—and ordinary consumers dream of owning.



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The Global Brand Scoreboard

RANK	2003 BRAND VALUE $MILLIONS	2002 BRAND VALUE $BILLIONS	PERCENT CHANGE	COUNTRY OF OWNERSHIP	DESCRIPTION
11 TOYOTA	20.78	19.45	+7	Japan	Always solid, if stodgy, Toyota stole a march on Honda with aggressive into eco-friendly hybrid cars and low-priced models for younger buyers.
12 HEWLETT-PACKARD	19.86	16.78	+18	U.S.	Many feared the next Titanic when it acquired Compaq last year, but emerged relatively unscathed and more profitable than before.
13 CITIBANK	18.57	18.07	+3	U.S.	Latest phase of its successful "Live Richly" campaign included ads sh 17 countries, characterizing a firm with global reach but a down-home
14 FORD	17.07	20.40	–16	U.S.	Sky-high rebates and 0% financing took some of the shine off Bill For lineup; snazzy new SUVs from Japan and Europe are stealing more th
15 AMERICAN EXPRESS	16.83	16.29	+3	U.S.	American Express punched up ad spending to target retail customers Now they use cards to pay for groceries, gas, even rent.
16 GILLETTE	15.98	14.96	+7	U.S.	In an era of falling consumer prices, the King of Blades still manage get shavers to pay premium prices.
17 CISCO	15.79	16.22	–3	U.S.	It played the downturn beautifully to generate record profits. But the bran still mired in the networking depression that followed the Net boom.
18 HONDA	15.63	15.06	+4	Japan	Sagging sales in its home Japanese market have yet to dent its reno reliable, dependable products.
19 BMW	15.11	14.43	+5	Germany	The Ultimate Driving Machines are fast, fun, stylish—and now come in flavors. A rapidly expanding lineup primed global growth.
20 SONY	13.15	13.90	–5	Japan	Still the platinum brand in gizmos, but rivals Panasonic and Samsun catching up with snazzy cell phones, digital cameras, and flat-panel
21 NESCAFE	12.34	12.84	–4	Switzerland	The world's favorite instant coffee advertised heavily to attract young coffee drinkers.
22 BUDWEISER	11.89	11.35	+5	U.S.	The King of Beers continued to swipe market share, despite rivals' w ad campaigns built around twins and female mud wrestling.
23 PEPSI	11.78	11.14*	+6	U.S.	With innovations like Twist, Wild Cherry, and Pepsi Blue, this fizzy ri was determined to catch up with Coke.
24 ORACLE	11.26	11.51	–2	U.S.	The software giant had always been a Silicon Valley maverick. Now a "corporate raider" to the long list of adjectives.
25 SAMSUNG	10.85	8.31	+31	S. Korea	Riding the electronics industry's shift to digital products, it wowed consumers with a blizzard of feature-packed gadgets and leading-edge
26 MORGAN STANLEY	10.69	11.21	–5	U.S.	Once a seemingly invincible white-shoe firm, it struggled to rise abo Wall Street's scandals involving analysts' investment-banking conflic
27 MERRILL LYNCH	10.52	11.23	–6	U.S.	Merrill sought to escape the tarnish of scandals, while its retail busi tried to move beyond its rep as a thundering herd of brokers.
28 PFIZER	10.46	9.77	+7	U.S.	A master acquirer and marketer, it leveraged a stable of top-selling d that includes Viagra and Lipitor, the world's sales leader.
29 DELL	10.37	9.24	+12	U.S.	Annoying pitchman Steven is gone, but that didn't slow the pace of sales or assaults on new markets like printers and PDAs.
30 MERCK	9.41	9.14	+3	U.S.	Patent expirations dampened earnings growth, but Merck continued cultivate its image as a research leader.
31 JPMORGAN	9.12	9.69	–6	U.S.	Viewed by many as the banker's bank, it suffered from corporate scandals slump in mergers and IPOs. Heavy exposure to derivatives is also a dark c
32 NINTENDO	8.19	9.22	–11	Japan	This former master of the video-game universe saw its empire shrink the wake of an onslaught from Sony's PlayStation and Microsoft's Xb
33 NIKE	8.17	7.72	+6	U.S.	An extreme marketing effort during soccer's World Cup and tie-in to Woods showed there's more to sporting goods than basketball shoes.
34 KODAK	7.83	9.67	–19	U.S.	Steadily falling film sales and a sputtering digital strategy could mea that Kodak's moment has passed.
35 SAP	7.71	6.78	+14	Germany	Behind sharper marketing and a strong sailing tie-in, the German so giant survived the tech downturn looking more solid than ever.
36 GAP	7.69	7.41	+4	U.S.	Bright colors and a fresh new ad campaign helped lift it out of a sal
37 HSBC	7.57	N/A	N/A	Britain	The 138-year-old lender's frugal management built the world's second-la retail bank through acquisitions in the U.S., Europe, and developing ma
38 KELLOGG'S	7.44	7.19	+3	U.S.	Boosted market share by sprinkling fruits into its flakes and pepping marketing with pitchmen like Disney's Winnie the Pooh.
39 CANON	7.19	6.72	+7	Japan	Already the world's top copier and laser-printer company, it emerged major force in digital cameras, too.

*Pepsi's 2002 brand-value data was revised upward due to new data.

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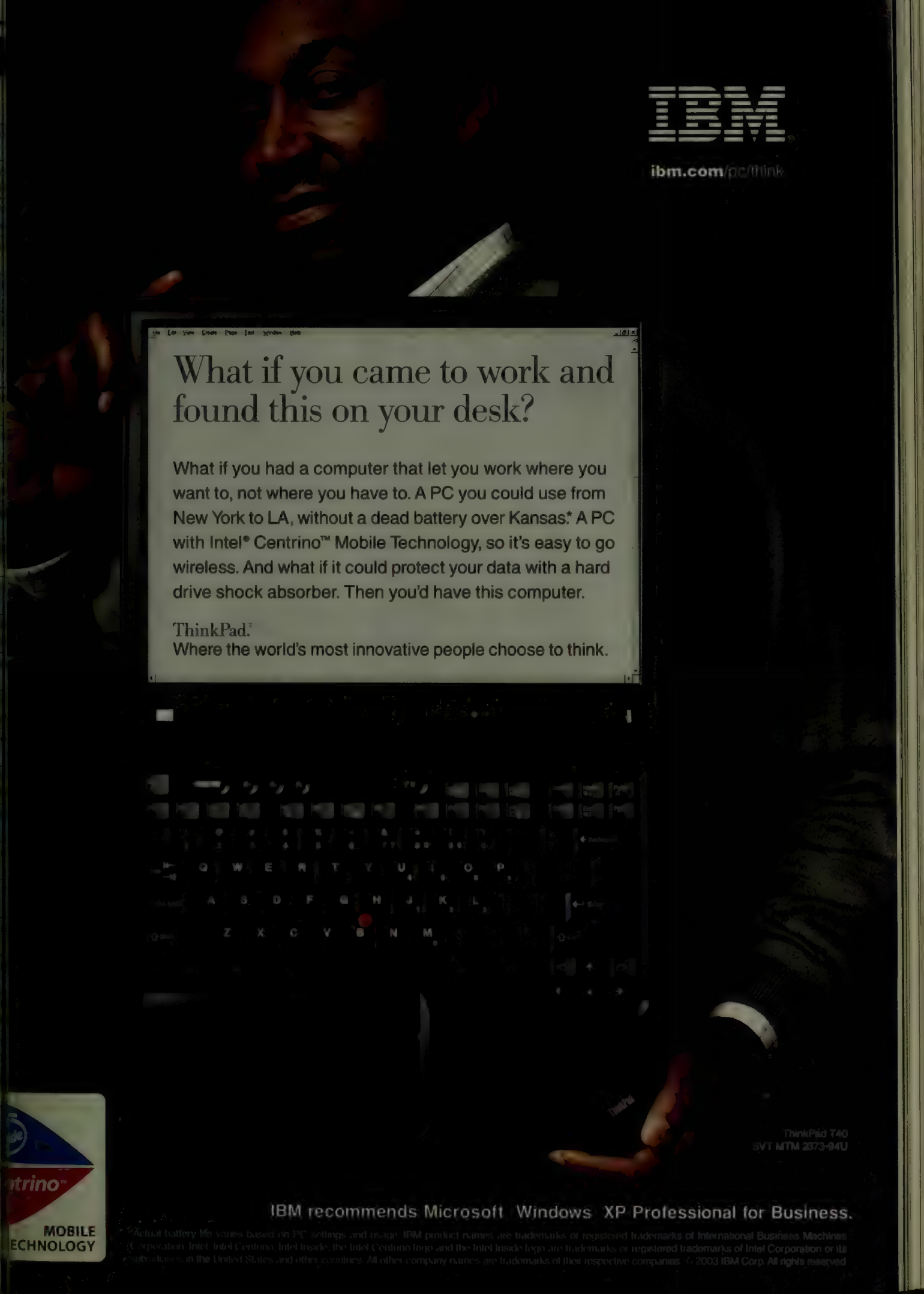
The Global Brand Scoreboard

RANK	2003 BRAND VALUE $BILLIONS	2002 BRAND VALUE $BILLIONS	PERCENT CHANGE	COUNTRY OF OWNERSHIP	DESCRIPTION
40 HEINZ	7.10	7.35	–3	U.S.	The world's favorite ketchup now comes in upside-down bottles and like "stellar blue." But competition took a bite.
41 GOLDMAN SACHS	7.04	7.19	–2	U.S.	Raising capital for Corporate America made it arguably the most prestigiou investment bank. But a drought in mergers and equity issuances took a to
42 VOLKSWAGEN	6.94	7.21	–4	Germany	The stalwart maker of quality mass-market cars suffered from high co aging lineup, fierce French competition, and a slew of overlapping br
43 IKEA	6.92	6.55	+6	Sweden	The chain made flat-packed furniture both affordable and fashionab bringing its concept of democratic design to 31 countries.
44 HARLEY-DAVIDSON	6.78	6.27	+8	U.S.	Aging customers still think Harley when they think motorcyle. They' rich enough to afford such innovations as the sleek $18,000 V-Rod
45 LOUIS VUITTON	6.71	7.05	–5	France	A downturn in tourism slowed this awesome profit machine fueled b monogrammed bags and accessories.
46 MTV	6.28	6.08	+3	U.S.	Still a big favorite among teens, and not just in the U.S. MTV Interr al was one of the fastest-growing businesses at parent Viacom Inc.
47 L'OREAL	5.60	5.08	+10	France	Who's boycotting France? Not the millions of women who made L'Or the No.1 cosmetics seller in the U.S.
48 XEROX	5.58	5.31	+5	U.S.	With new financing and a range of hot color products, the troubled company's image was on the mend.
49 KFC	5.58	5.35	+4	U.S.	The chicken chain goosed global business by promoting local fare— pura crispy strips in Japan and potato-and-onion croquettes in Holla
50 APPLE	5.55	5.32	+4	U.S.	The "i's" have it—iPod, iTunes, and iBooks lifted the perennial underdo the innovative Music Store download service left rivals in the dust.
51 PIZZA HUT	5.31	6.05	–12	U.S.	The dough wasn't rising. Asian restaurant sales were hurt by SARS, whil home the chain was slow to sling popular new products such as wings.
52 ACCENTURE	5.30	5.18	+2	U.S.	Hit hard by the slump in telecom, the consulting icon took its own a and nimbly built its outsourcing specialty.
53 GUCCI	5.10	5.30	–4	Italy	Chief designer Tom Ford was still a hit on the catwalks of Paris and N York, but Gucci's profits were shredded by economic stagnation and S
54 KLEENEX	5.06	5.04	0	U.S.	From aromatherapy tissues to 3-D holiday boxes, this leader still ma to pull out some fresh ideas.
55 WRIGLEY'S	5.06	4.75	+7	U.S.	Hip ad campaigns to relaunch core brands Juicy Fruit and Doublem and introduction of new sugar-free gum reinvigorated the chew-chew
56 COLGATE	4.69	4.60	+2	U.S.	As it neared the end of its second century, the brand continued to w over more smiles.
57 AVON	4.63	4.40	+5	U.S.	The Avon Ladies were on a tear, leveraging healthy R&D and marketi budgets through online sales and an expanding door-to-door network
58 SUN MICROSYSTEMS	4.47	4.77	–6	U.S.	A perception that this computer maker wasn't keeping up with techn trends made it appear as less than cutting-edge.
59 PHILIPS	4.46	4.56	–2	Netherlands	In Europe, its name equals home electronics, but Philips struggled v awareness in the U.S. and perennially tough competition from Asia.
60 NESTLE	4.46	4.43	+1	Switzerland	From chocolate to baby formula, the Swiss food giant keeps the worl pantry stocked.
61 CHANEL	4.32	4.27	+1	France	A symbol of Parisian sophistication for mom's generation, but Chane a harder time luring younger customers.
62 DANONE	4.24	4.05	+5	France	The maker of Dannon yogurt, already a powerhouse in Europe, was b big on emerging markets.
63 KRAFT	4.17	4.08	+2	U.S.	The master of line extensions scored with new frozen-pizza flavors ar other products but lost share on its cheese business to private labels
64 AOL	3.96	4.33	–8	U.S.	Often dubbed the "Internet on training wheels," the king of the dial-up ser risked losing subscribers as they graduated to broadband connection
65 YAHOO!	3.90	3.86	+1	U.S.	This Internet icon soared again but will have to watch out for the Ne next killer brand: Google.
66 TIME	3.78	3.68	+3	U.S.	After winning a National Magazine Award for coverage of September the weekly ramped up again with excellent war reporting and photog
67 ADIDAS	3.68	3.69	0	Germany	The maker of athletic shoes and clothing suffered from a plunge in U sales as youths balked at paying more than $100 for a pair of sneak
68 ROLEX	3.67	3.69	0	Switzerland	Tough times failed to put a dent in the popularity of the signature St watches.
69 BP	3.58	3.39	+6	Britain	John Browne was once again front and center with his controversial "Beyond Petroleum" campaign. A megadeal in Russia also helped.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What if you had a computer that let you work where you want to, not where you have to. A PC you could use from New York to LA, without a dead battery over Kansas.* A PC with Intel® Centrino™ Mobile Technology, so it's easy to go wireless. And what if it could protect your data with a hard drive shock absorber. Then you'd have this computer.
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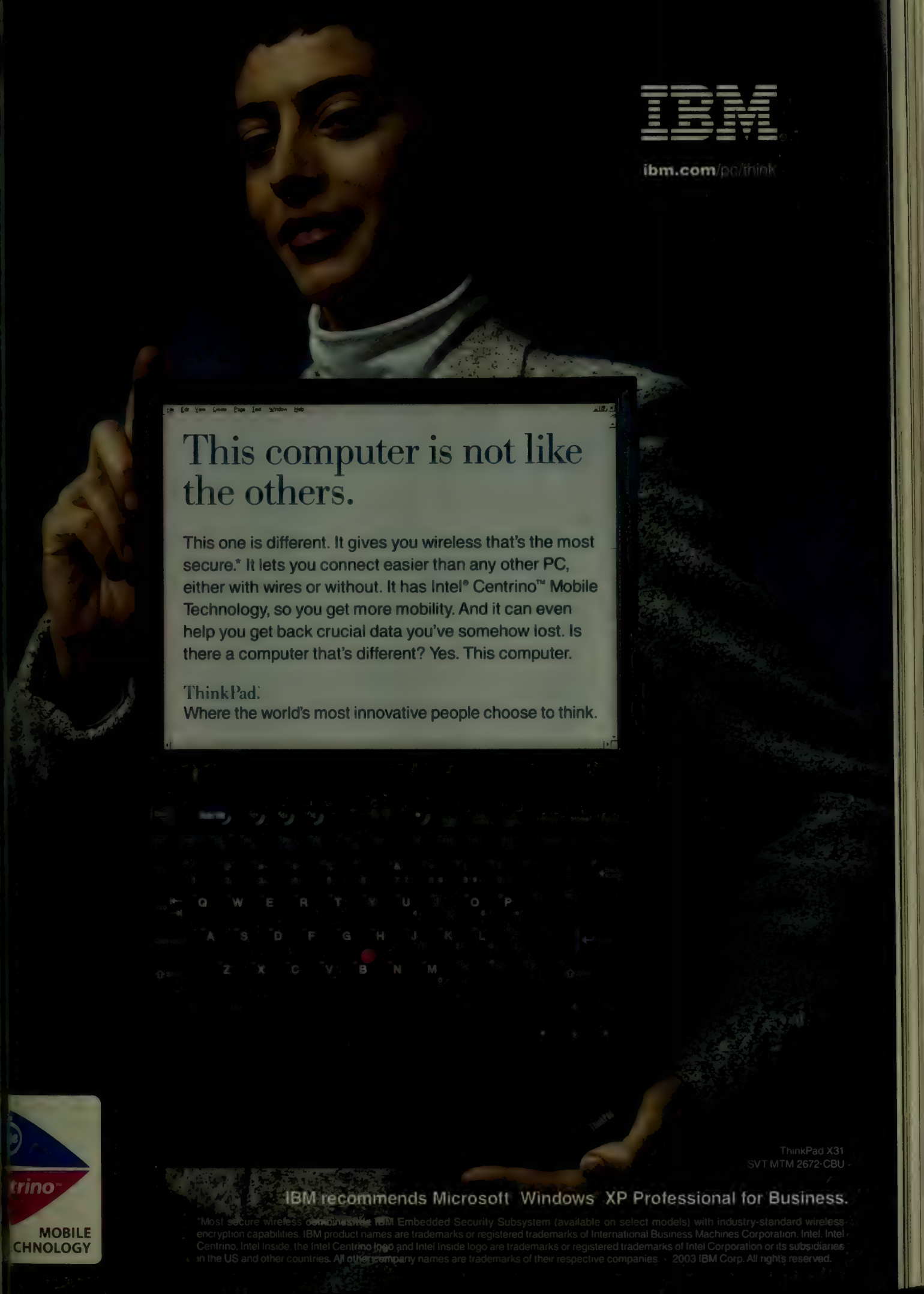
The Global Brand Scoreboard

RANK	2003 BRAND VALUE $BILLIONS	2002 BRAND VALUE $BILLIONS	PERCENT CHANGE	COUNTRY OF OWNERSHIP	DESCRIPTION
70 TIFFANY	3.54	3.48	+2	U.S.	Even hard times couldn't dim the luster of Tiffany's extravagant bau their signature blue box.
71 DURACELL	3.44	3.41	+1	U.S.	Terrorist fears bolstered battery sales, but the category remained hampered by cutthroat competition.
72 BACARDI	3.43	3.34	+3	Bermuda	New flavors, coupled with the popularity of the mojito—a Cuban rum julep—kept the venerable rum brand on the hip parade.
73 HERMES	3.42	N/A	N/A	France	Known for classic scarves and leather goods, Hermes recently hired celebrity designer Jean-Paul Gaultier to update its image.
74 AMAZON.COM	3.40	3.18	+7	U.S.	Amazon's relentless focus on making online buying easier—not to m steady progress toward profits—improved its standing among consu
75 CATERPILLAR	3.36	3.22	+5	U.S.	The economy gave Cat a rough ride, but the heavy-equipment and e maker bulldozed ahead, strengthening earnings through cost-cutting
76 REUTERS	3.30	4.61	–28	Britain	The news and data service still had not found the formula to outgun financial-screen rival Bloomberg in a weak market.
77 LEVI'S	3.30	3.45	–5	U.S.	This struggling American icon has tried—sometimes too hard—to be but it's also going mass-market with a line for Wal-Mart.
78 HERTZ	3.29	3.36	–2	U.S.	Saddled with a difficult travel market, Hertz Rent-A-Car had a tough standing out as the premium choice. This company will have to try h
79 PANASONIC	3.26	3.14	+4	Japan	Once a dowdy line of home electronics, Matsushita's Panasonic bran stood for style, quality, and function-packed products.
80 ERICSSON	3.15	3.59	–12	Sweden	The cellular equipment giant survived the telecom bust but faced a t future. Two years of sturm and drang have taken a toll.
81 MOTOROLA	3.10	3.42	–9	U.S.	This electronics brand was cut down to size by intense competition a weak demand, while product delays put customers on hold.
82 HENNESSY	3.00	N/A	N/A	France	Hip-hoppers and other celebs made this top-of-the-line cognac releva a new generation of drinkers.
83 SHELL	2.98	2.81	+6	Brit./Nether.	CEO Phil Watts drove a money machine fueled by $30 oil prices and hard-nosed cost-cutting.
84 BOEING	2.86	2.97	–4	U.S.	Management worked hard to prove the brand stood for more than commercial airliners, only to fall behind Airbus in that crucial marke
85 SMIRNOFF	2.81	2.72	+3	Britain	Shook up the booze business with its introduction of flavored vodkas a range of ready-to-drink Smirnoff spin-off products.
86 JOHNSON & JOHNSON	2.71	2.51	+8	U.S.	The halo effect from J&J's trusted consumer brands helped the comp sales reps as they marketed a broad lineup of drugs and devices.
87 PRADA	2.54	2.49	+2	Italy	The Italian icon's minimalist clothing, nylon handbags, and ultra-trendy shoes took fashion capitals by storm, but heavy debt slowed its strut.
88 MOET & CHANDON	2.52	2.45	+3	France	With sales up 14% last year, it kept the bubbly flowing at parent con LVMH Moet Hennessy Louis Vuitton.
89 NISSAN	2.50	N/A	N/A	Japan	On a roll under new management from Renault, but the brand's repu had yet to catch up to Nissan's crowd-pleasing new models.
90 HEINEKEN	2.43	2.40	+1	Netherlands	Young people were drinking less, but if they spend more for quality, t Dutch-made premium beer could prosper.
91 MOBIL	2.41	2.36	+2	U.S.	Success of its reformulated Mobil 1 motor oil, racing sponsorships, and status as NASCAR's official lubricant reinvigorated this ExxonMobil fran
92 NIVEA	2.22	2.06	+8	Germany	Hamburg-based parent company Beiersdorf kept the skin cream grow by spreading it into categories such as sun protection and deodorants
93 STARBUCKS	2.14	1.96	+9	U.S.	This fast-growing brand continued to corner the U.S. market, althoug hit some speed bumps overseas.
94 BURGER KING	2.12	2.16	–2	U.S.	As talks dragged on to sell the Home of the Whopper, it suffered from a menu, management exodus, and financial strains among some franchis
95 POLO RALPH LAUREN	2.05	1.93	+6	U.S.	Another record year for the preppy purveyor of American style that launched in 1967 as a line of flamboyant ties.
96 FEDEX	2.03	1.92	+6	U.S.	FedEx was riding high behind a successful expansion of its ground hom delivery service, stealing market share from leader United Parcel Servic
97 BARBIE	1.87	1.94	–3	U.S.	The babe in pink reinvented herself as a DVD movie star, even taking a sp around Swan Lake. But she's slipping against fresh new competitors like B
98 WALL ST. JOURNAL	1.76	1.96	–10	U.S.	The downturn in advertising, especially for business publications, pummeled the Dow Jones flagship.
99 JOHNNIE WALKER	1.72	1.65	+4	Britain	Four bottles of this nearly 200-year-old blended scotch whiskey are consumed every minute, making it owner Diageo's most spirited bran
100 JACK DANIELS	1.61	1.58	+2	U.S.	A global push and marketing campaign to appeal to women and youn drinkers means Jack Black ain't just for Good Old Boys anymore.

The brand valuations draw upon publicly available information, which has not been independently investigated by Interbrand. Valuations do not represent a guarantee of future performance of the brands or com

Data: Interbrand Corp., J.P. Morgan Chase & Co., Citigroup, Morgan Stanley, *BusinessWeek*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This computer is not like the others.
This one is different. It gives you wireless that's the most secure.* It lets you connect easier than any other PC, either with wires or without. It has Intel® Centrino™ Mobile Technology, so you get more mobility. And it can even help you get back crucial data you've somehow lost. Is there a computer that's different? Yes. This computer.
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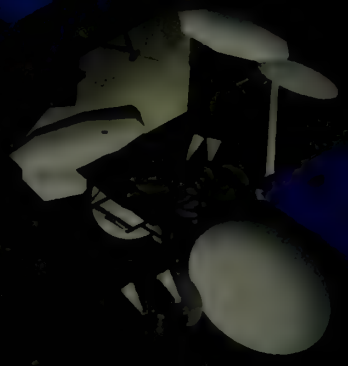
WHAT'S SHOOTING DOWN SATELLITE SALES



Congress needs to refine strict licensing rules meant to keep unfriendly states from buying U. S. technology

COMMENTARY

By Stan Crock

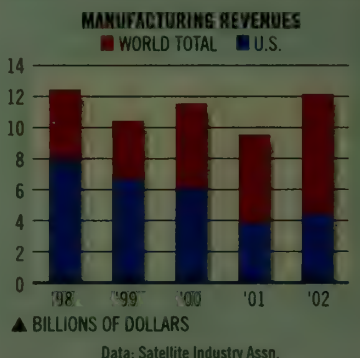
It's hard to find a more loyal customer for U.S. satellites than Telesat Canada. In the past 30 years, this unit of BCE Inc. has bought 14 birds, all from south of the border. But in March the Ottawa company announced it was buying a spacecraft from France's Astrium. After gaining experience with the new gear, Telesat will be less likely to return to U.S. suppliers: "It's very much easier to buy a second and a third," notes Roger J. Tinley, Telesat's vice-president for space systems.

What caused the shift? The inability of Congress to distinguish between an aircraft carrier and a TV satellite. In 1998, lawmakers put satellites on the State Dept.'s munitions list alongside traditional weapons, imposing the strictest export standards. Licensing, monitoring, and notifying Congress of each export deal may work for selling fighters to foreign governments but doesn't fly in the commercial world. "It's very difficult to do business with U.S. companies," Tinley gripes.

Satellites are Exhibit A in the case against Washington's quixotic attempt to regulate exports of widely available commercial products. The global spread of technology has rendered almost all such efforts obsolete. After the tough export rules took effect, America's share of global satellite sales plummeted from 64% of the $12.4 billion market in 1998 to 36% of the $12.1 billion market in 2002, according to the Satellite Industry Assn. And the U.S. turned from a net exporter of commercial birds and parts to a net importer. On July 15, former high-flier Loral Space & Communications Ltd. filed for Chapter 11 bankruptcy. The same day, Boeing Co. announced a $1.1 billion charge for its space operations—further evidence that export rules handicap U.S. companies reeling from a stagnant world economy and the telecom bust. "We are jeopardizing America's dominance of the satellite industry," declares Representative Dana Rohrabacher (R-Calif.), who backed the 1998 rules but now has second thoughts.

SATELLITE SLUMP

America's incredible shrinking market share



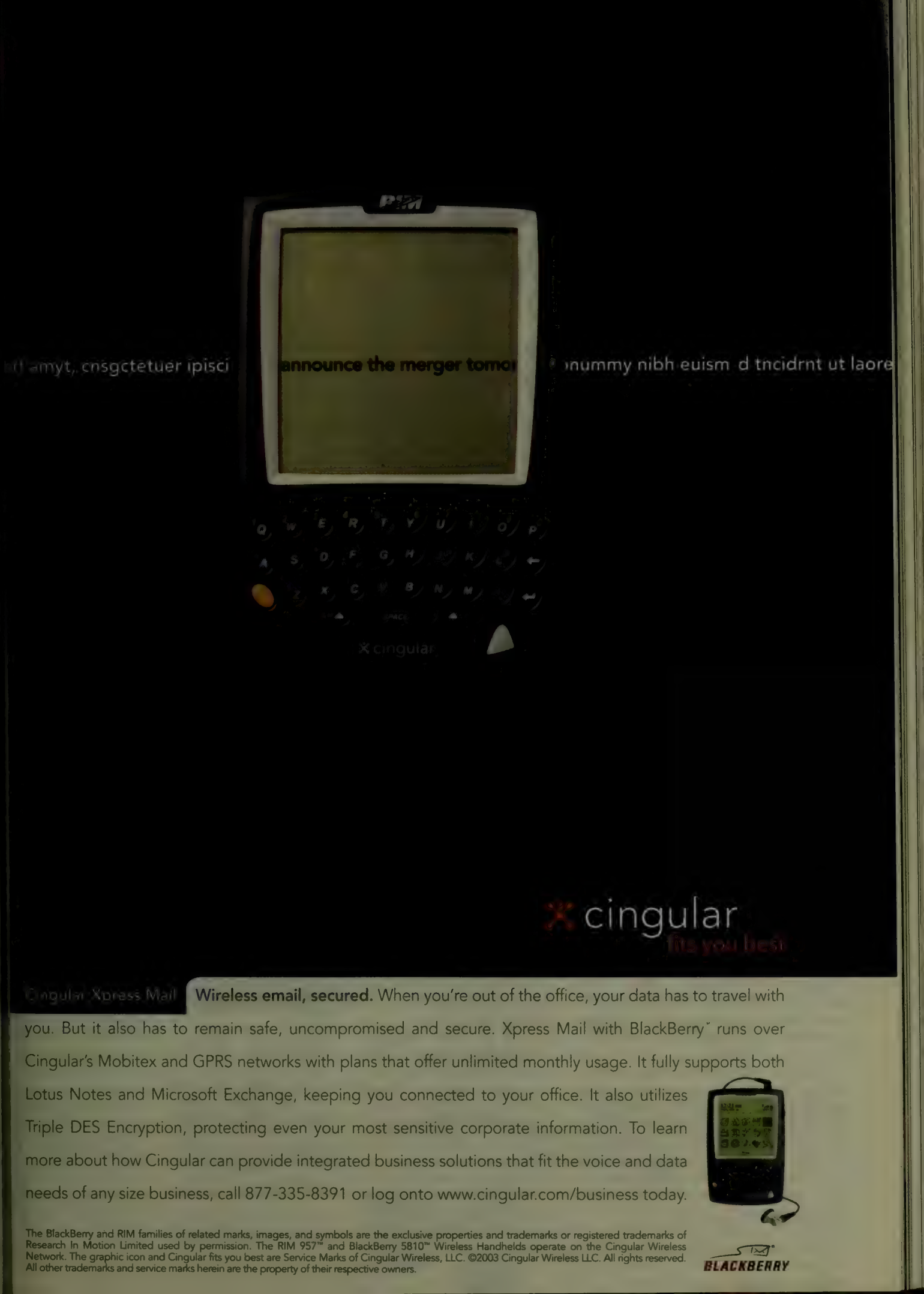
Data: Satellite Industry Assn.

The iron law of unintended consequences is clearly at work. A policy designed to deprive America's potential enemies of advanced spying and communications technology while protecting America's hardware edge has been ruinous on both counts. The barriers to U.S. sales have spurred rivals overseas to offer a variety of satellite services, so any adversaries can easily buy imaging and communications services elsewhere. And by making U.S. companies less attractive suppliers, the rules crippled an industry the Pentagon wants to rely on for space-based and lasers. The industry's "foun are being eaten away," says Loral man and CEO Bernard L. Schwar

A BOEIN TO BE B FOR A MALAYS TV OUTF

The snafu is a larger proble port curbs mak sense when app "dual-use" it products, such a puters, with bot tary and comm applications—th available in places. Custome want to continu ing U.S. tech suffer the dela eventually get es, while ter and unfriendly bypass the system. The solutio stead of spending millions on b cracies to grind out licenses, Co should shift the money to intell agencies to better monitor what ica's adversaries are trying to bu spooks should forget about dual-us and focus on blocking sales of military technology, such as s equipment, for which there is no mate commercial market.

Trouble is, Congress seems inc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Wireless email, secured. When you're out of the office, your data has to travel with you. But it also has to remain safe, uncompromised and secure. Xpress Mail with BlackBerry™ runs over Cingular's Mobitex and GPRS networks with plans that offer unlimited monthly usage. It fully supports both Lotus Notes and Microsoft Exchange, keeping you connected to your office. It also utilizes Triple DES Encryption, protecting even your most sensitive corporate information. To learn more about how Cingular can provide integrated business solutions that fit the voice and data needs of any size business, call 877-335-8391 or log onto www.cingular.com/business today.
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BLACKBERRY

of fixing the system. The 1998 law grew out of allegations that Hughes, whose satellite operations Boeing later acquired, and Loral leaked satellite knowhow to China. Both paid large fines to settle the charges without admitting or denying wrongdoing.

The cases prompted GOP lawmakers during the Clinton Administration to give the State Dept. authority over space exports, taking it away from what Congress considered a lax Commerce Dept., which has jurisdiction over dual-use items. It wasn't a minor change. Each deal now requires approval by Congress, which has no deadline for acting. Foreign customers don't know whether or when a license will be granted. And when a part, such as an amplifier, fails in orbit, the spacecraft's maker must get a new license before the foreign customer can talk to its supplier or insurer. Anyone who buys European can resolve the problem the next day.

Industry efforts to return licensing power to Commerce have failed, so now companies' goals are more modest: Give the President discretion to switch some licensing authority back to Commerce. But with a divided Bush Administration on the sidelines and the China specter lurking in the shadows, not even 360 meetings between industry lobbyists and Capitol Hill staffers last year could end a stalemate between right-wing Republican factions over the issue.

Free-trader Rohrabacher wants the President to be able to use Commerce's simpler export process for sales to NATO and major non-NATO allies. Satellites are the only munitions-list item for which the President doesn't have this discretion—which suggests the birds are more of a threat than nuclear subs. But House Armed Services Committee Chairman Duncan Hunter (R-Calif.), an America-firster, nixed the idea in his panel and prevailed when the House voted on July 15. Hunter wrote to colleagues saying that Rohrabacher's plan "threatens U.S. national security" by allowing sales to countries with unreliable export controls, such as Bahrain. A Senate version would exempt marketing overtures—but not sales—to NATO countries, Australia, Japan, and New Zealand from State Dept. licensing.

Even this tepid approach may not become law. Yet, clearly, a major overhaul is required. Only by freeing dual-use technology from export red tape can the U.S. win back customers like Telesat. A boost in satellite sales will help preserve America's competitive edge, and avoid what looks like strategic suicide.

Crock covers defense in Washington.

Corporation

STRATEGIES

THE HEAT IN KRAFT'S KITCHEN

Cheap rivals and demands for leaner fare close in

Few things in the food business are as bankable as Kraft Foods Inc.'s extending one of its powerful brands. But when Kraft flooded supermarkets last winter with a microwavable Ooey Gooey Warm 'n Chewy version of Chips Ahoy cookies, shoppers were unimpressed. Worried about microwave safety, Kraft had dialed down the heating instructions. The result was a less than gooey, altogether not ooey-tasting cookie—and overpriced to boot. Kraft wound up paying $5.5 million in the second quarter to pull unsold cookies off store shelves, enough to shave 1¢ a share off its bottom line.

That's not the only misfire at Kraft. After a two-year honeymoon in which she seemed to have figured out how to wring consistent growth from the $29.7 billion food manufacturer, Kraft co-CEO Betsy D. Holden, 47, is suddenly feeling pressure from all sides. The departure of two top operations executives on the same day, July 9, raised concerns about thinning ranks in Kraft's executive suite, where Holden shares the CEO duties with international chief Roger K. Deromedi, 49. Then, on July 16, Kraft shocked investors by acknowledging that it had failed to meet second-quarter expectations and was lowering earnings forecasts for the rest of 2003.

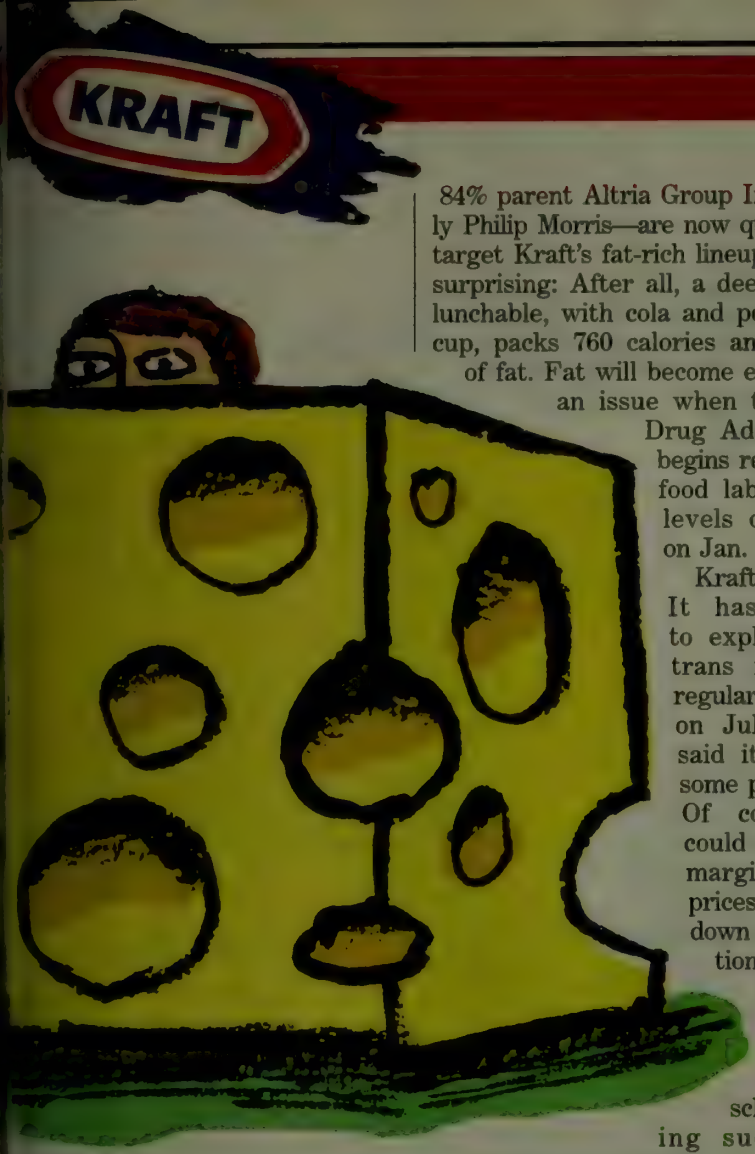
All Kraft's flagship businesses—cheese, biscuits, cold cuts, and coffee—lost market share and sales volumes in the spring. The announcement drove the stock down by $2 in one day. Today it trades around $29, off 26% since Jan. 1. An overreaction to one bad quarter? Not exactly. What's spooking investors is Kraft's sluggish response to a pair of threats that have been building for the past year: an attack on its core brands by cheap private-label goods, and a rising demand for less fattening, more healthful food. "Kraft's bulletproof reputation as a steady grower was shattered," says Daniel Peris of Federated Investors Inc., which owns 286,000 Kraft shares. "Everyone suddenly realized that it's just a regular packaged-food company, not a superior one."

What had placed Kraft a cut above and warranted its long-term 3%-to-4% volume growth target was its reputation as an innovator. Indeed, Holden, an ex-teacher w MBA from Northwestern Unive J.L. Kellogg Graduate School of agement, sped th the ranks as a mar whiz by pulling of tricks as convertir DiGiorno pasta brar a powerhouse tha tured 19% of the pizza business. L ables, a combo of crackers, cheese, d or candy, exploded scratch in 1988 to million business Sales of Oreo, the cookie in the leaped 9% after chocolate creme var were introduced in

Lately, however products have sput Besides the Ooey flop, a squeezable of cream cheese— delphia To Go!—ha erated less than $5 in sales per month its launch late last And several com were faster off the

Cheese, cold cuts, and coffee have lost sales volume, and the stock has fallen

CO-CEO BETSY HOLDEN



84% parent Altria Group Inc.—formerly Philip Morris—are now queuing up to target Kraft's fat-rich lineup. That's not surprising: After all, a deep-dish pizza lunchable, with cola and peanut-butter cup, packs 760 calories and 28 grams of fat. Fat will become even more of an issue when the Food & Drug Administration begins requiring that food labels disclose levels of trans fat on Jan. 1, 2006.

Kraft's response? It has promised to explore cutting trans fats out of regular Oreos. And on July 1, Kraft said it would cut some portion sizes. Of course, that could raise profit margins, if unit prices don't come down by a proportionate amount. Kraft also said that it would eliminate in-school marketing such as ads on classroom Channel 1 and product sampling, although for now it will still stock school vending machines. Holden vowed to review all of Kraft's products to see where it could provide reduced-fat alternatives. "The only way we're going to make progress against obesity is if all sectors of society do their part—and that includes the food industry," Holden said in an e-mail interview.

Analysts, several of whom have downgraded Kraft in the past month, worry even more about a price squeeze on such core brands as Kraft Singles, Maxwell House, Oscar Meyer, and Ritz. They say that starting last year, Holden should have been more aggressive in meeting the threat from private-label products. Grocery chains, trying to stave off discounters such as Wal-Mart Stores Inc. and Costco Wholesale Corp., have loaded up on those goods, which deliver fatter margins at lower prices: a 12-count package of American cheese singles from Kraft sells for $2.99, vs. $1.99 for Albertson's Inc.'s version.

Holden was determined not to get into a pricing war. In fact, she increased prices on cold cuts and coffee as commodity costs climbed. But when the competition balked and Kraft didn't respond quickly enough with promotions, it paid the price. Kraft's sales of natural cheese in the past five months rose just 1%, while private-label cheese jumped 13%, according to Merrill Lynch & Co.

Now Holden is upping the ante. Kraft will boost its multibillion-dollar marketing budget in the second half by a further $200 million, much of it to bolster core brands. And price cuts are coming in selected areas. That combination might get sales growing again, but it is also a big reason why Kraft will miss its earnings targets.

Amid all these challenges, Holden is also fighting off criticism that she has found it hard to hold on to key talent. That started with the 2001 departure of Ann Fudge, a rival for the top Kraft job who is now CEO of Young & Rubicam. It continued with the July departures of Irene B. Rosenfeld, Holden's No.2 as president of Kraft North America, and Michael B. Polk, who left as president of the biscuits and snacks division to become chief operating officer of Unilever Bestfoods North America. Holden counters that Kraft has had relatively little turnover at the top, adding: "Because we have such a depth of talent, there sometimes are people who want certain jobs, including CEO, faster than is possible here."

For most of her tenure, Holden had little trouble hitting her targets. That's thanks in no small part to a masterly integration of Nabisco Group Holdings Corp., which Philip Morris bought in 2000 for $19 billion. But some worry the resulting portfolio of products is unwieldy. Clearly, Holden disagrees. But she'll have to show some deft kitchen management in order to hold off the competition and wring the fat out of Kraft's lineup.

By Pallavi Gogoi in Chicago

ferings that respond to rising con-
about fatty foods. Last Septem-
psiCo Inc. began to remove trans
cids, which boost levels of harmful
erol, from its three popular snack
. Doritos, Tostitos, and Cheetos
% free of trans fat, and Pepsi's
for you" snacks grew 28% by
in the second quarter. General
nc. and Kellogg Co. have greatly
ed their cereal lines with health-
d extensions such as adding solu-
r to Honey Nut Cheerios. Mean-
some critics say Kraft let its Post
wilt. "Cereal is all about new fla-
nd new items that are good for
and Kraft hasn't kept up," says
r McCaffrey of McCaffrey's, a
rocery chain in Langhorne, Pa.
e of the same lawyers who
d cigarette suits against Kraft's

Y WAY U SLICE IT, AFT HAS OBLEMS

$1
Price gap between a 12-count pack of American cheese singles from Kraft ($2.99) and private-label Albertson's ($1.99)

14 GRAMS
Fat count for six Oreo cookies, which comes to 22% of the recommended daily total

–5%
Sales drop for Nabisco cookies in the second quarter, partly caused by flop of Ooey Gooey Warm 'n Chewy Chips Ahoy

EXECUTIVE SUITE

PASS GO AND COLLECT THE JOB OF CEO

After 38 years at Hasbro, the toy-and-game giant, Al Verrecchia wins the prize

Alfred J. Verrecchia, the new chief executive of Hasbro Inc., America's second-largest toy company, is a suit's suit. He's tall, poker-faced, and perfectly coiffed. After working at Hasbro for 38 years, starting as a junior accountant, he can reel off stats like nobody's business. He drills managers in risk-reward analysis and has been known to curse toys that don't perform well. Over the years, it has been Verrecchia who in various guises has made the tough, sometimes painful decisions at the family-run company. "I'm probably the hammer in the organization," he says.

No kidding. For years, he has been the heavy for Alan Hassenfeld, the 54-year-old grandson of the company's founder. Hassenfeld, who controls the family's 10.8% stake in Hasbro, surrendered the sandbox in May after a somewhat chaotic 14-year reign. He'll remain chairman and work full-time, focusing on philanthropy, governance, and the creative side of the nearly $3 billion business.

Hassenfeld often appeared uncomfortable playing the authority figure at the company. Hassenfeld doesn't wear socks, keeps rubber bands on his wrists for good luck, and seems eager to slip away and play a round of Scrabble, his favorite game. When he gushes about his children, he means Mr. Potato Head, G.I. Joe, and Raggedy Ann. His conversation is peppered with quips: He loves G.I. Joe, for example, "because he put me through college." Hassenfeld hates to fire anybody or even to have to choose among underlings for promotions. In 1989, he asked Verrecchia to share the job of chief operating officer with a colleague for just that reason.

Hassenfeld's decision to relinquish the CEO role was more than a mere passing of the torch at one of America's best-loved family empires: It signals that Hasbro is growing up. To which most investors might say: It's about time. "Verrecchia recognizes what the company needs and can execute," says Sean McGowan, a managing director at Harris Nesbitt Gerard. "Hassenfeld's leadership style was hands-off and consensus-building to the point of paralysis."

Indeed, after a failed takeover attempt by Mattel in 1996, Hassenfeld tried to revitalize Hasbro any which way. He brought in a consultant who rearranged parts of the organization like so many Legos. Outside executives came and went. Verrecchia, meanwhile, lost influence. "He had a role a little outside the mainstream," says Dan D. Owen, a former senior executive. The company neglected its traditional brands and instead chased hot licenses tied to movies such as *Star Wars* and *Spider-Man*. Divisions acted like unruly siblings, competing against each other for attention. "Hasbro lost focus on the consumer. We became competitive inside instead of outside," says Brian Goldner, president of U.S. Toys.

The reckoning came in 2000. That year, Hasbro's revenue fell more than 10%, to $3.8 billion, and it lost $144.6 million. Hassenfeld gave up on the outside experts and turned to the person who had always helped him out before: Verrecchia. Hassenfeld promoted him to president in August, and Verrecchia quickly initiated crucial changes—including moving all the far-flung toy divisions to headquarters in Pawtucket, R.I., to cut costs and get them to work together; reducing $1.2 billion in long-term debt; and focusing on extending Hasbro's main brands, such as G.I. Joe, Monopoly, and Easy-Bake Oven. The situation has improved since then: Hasbro's revenue in the second quarter was $581.5 million, up 7% from the year before; it earned $11.4 million after losing $25.9 million a year ago. Hasbro's stock has risen about 60% since August, 2000, when Verrecchia introduced the new strategy. And in a switch from Hasbro has three of the top 10 t the market, while Mattel has just

For Verrecchia, now 60, the r was becoming CEO of a company long served as if it were his own. Alan's older brother, Stephen D. senfeld, ran the company, Verr was among his top lieutenants. death in 1989, Verrecchia says: "I Alan and me a great company. I think we want our legacy to be t drove it into the ground." Now, f first time, Verrecchia is in charge. senfeld's 34-year-old nephew, M was in charge, Alan Hassenfe out any assurance that one d could become CEO.

Al Verrecchia

BORN Feb. 19, 1943, in Providence

EDUCATION BS in accounting, 1967, and MBA, 1972, University of Rhode Island

CURRENT POSITION The first boss Hasbro has ever had outside the Hassenfeld family

BONA FIDES Has worked at the company his entire career, starting out as a junior accountant in 1965. Served as chief financial officer, co-COO, and president—much of the time mentoring the family scion who

THE ODD COUPLE Detail-orie Verrecchia is Felix to Alan Hassenfeld's organizationally challenged Oscar.

PLAY IS THE THING CEO Verrecchia, left, and Chairman Hassenfeld, who calls him "next to my brother, my greatest mentor"

is president of Mexico and Latin
ca operations.)
recchia, who came of age in a mid-
ss family living outside Providence,
d out of the University of Rhode
because he wasn't sure what ca-
o pursue. He was pretty sure,
, that he didn't want to join his
s jewelry business. When Ver-
returned to school, he stud-
counting; while still there, a
professor who was a comp-
at Hasbro offered him
It was 1965, and the
ny's sales totaled

just $30 million. Verrecchia recalls walking each morning with Alan's father, Merrill, to the mail room, where they would tear open orders to see how the company was doing. Even back then, when there was dirty work to do, like begging suppliers for more time to pay up, Verrecchia did it.

Stephen took over after Merrill died in 1979 and ran Hasbro until his death at age 47 from AIDS. That left Alan next in a short line of CEO candidates. He had worked for the company, mostly in Hong Kong, but had scant experience in finance or management. Still, he wanted the job. So the ever-loyal Verrecchia backed him up, just as Stephen had. "Al has been, next to my brother, my greatest mentor," says Hassenfeld. "He's taught me a great deal of discipline."

What some executives wouldn't give to have a mentor like Verrecchia. "The role Al plays is the extremely capable best friend," says Kevin Mowrer, a former senior executive at Hasbro. "He's the one who watches your back and is not afraid to tell you what he truly believes."

Consider just one example: Hassenfeld's pursuit of licensing deals related to movies. In 1997, Hasbro guaranteed minimum royalty payments of $590 million for the right to sell toys connected to the upcoming *Star Wars* movies. At the time, it was considered a smart move. But returns were disappointing, and Verrecchia had to step in to do damage control. "Al was the first to drill in on who's shipping what, what's selling, and how to manage it," says Mowrer. Under Hasbro's new strategy, it is putting less emphasis on such deals.

Of course, Verrecchia has made mistakes, too. Big ones. In the mid-'90s, he backed a project code-named Sliced Bread. It was a virtual-reality game that sucked up $40 million but never made it to market. "I use that as an example to tell people you can fail and still succeed," he says.

In the end, the world's children will be the ultimate judges of Hasbro. Last holiday season, they loved Beyblades (battling tops) and FurReal Friends (furry pets that react to touch). But industry consultants aren't enthusiastic about some of what's coming out. They had nothing good to say about Video Now, a handheld device that plays Nickelodeon cartoons but displays them in black-and-white on a tiny 2-inch screen. "Trying to pull kids away from Nintendo Game Boys to passively watch black-and-white on a small screen may prove to be a hard sell," says Frank Catalano, an independent analyst. But gadgets called Thin-Tronix, which combine electronics with toys, and a new version of the 37-year-old game Twister that uses music to direct the moves, could be more popular.

Back at toy central, one of Corporate America's oddest couples seems to have settled into a comfortable routine. Hassenfeld jokes that Verrecchia will probably serve for five years, "as long as I behave," and likes to tease the CEO about his newfound control over his old boss's spending. Hassenfeld, for the record, has yet to make a request. But you can tell how happy he is to pass the buck to Al. For years, Verrecchia has had a sign on his wall that says: "Al's problem emporium.... Why go anywhere else?" Now he finally has the title to go with the job.

By Faith Arner in Pawtucket, R.I.

TOY Snoopy
Machine, be-
like an annu-
keeps coming
year after year."

rried 39 years to Gerrie; they
hildren, two grandchildren.

WHY THIS MAN IS SMILING
Matza's firm, Neuberger Berma
was purchased at a steep prem

FINANCIAL SERVICES

QUICK! FOLLOW THAT MONEY MANAGER

The stock market rally has turned them into hot quarries

Buyouts of money managers and mutual-fund companies have kicked into gear. Lehman Brothers Holdings Inc. made the biggest splash on July 22 with its $2.6 billion purchase of asset manager Neuberger Berman Inc. But other big players, from American Express to Charles Schwab, are swooping in to buy part or all of companies that manage sizable portfolios. Citigroup, the nation's largest financial company, says it, too, is in the market. "There's a lot more stuff that hasn't hit the radar yet," says Kerrie MacPherson, head of Ernst & Young's financial services transactions group.

Why now? The biggest quarterly advance in stock prices since the end of 1998, coupled with an avalanche of new cash from investors, has given money-management firms a big profit lift. The companies generate higher fees as the assets they manage increase. And assets are soaring: Net flows into equity funds in June totaled an estimated $19.5 billion, according to fund tracker Lipper, the most since March, 2002. "A lot of managers are thinking, hey, there's some light at the end of this tunnel," says J. Christopher Donahue, CEO of Federated Investors Inc., which on July 18 bought eight mutual funds with $470 million in assets from Riggs National Corp., in Washington.

The buzz ignited the stocks o licly traded managers. The grou soared 24.5% this year through Ju double the increase in the Stand Poor's 500-stock index, according nancial-stock specialists Keefe, Br & Woods Inc. (KBW). Many o stocks—including Eaton Vance, ated Managers Group, and Janus Group—hit 52-week highs in mid-

But have stock prices—and the out bids—raced ahead of results? ations remain 17% above historic erages, at nearly 19 times exp fourth-quarter earnings, says Schorr, analyst with UBS Invest Research. "Investors may be ove mating improving fundamentals b derestimating cost pressures in the ness," he says. Negatives include n saturation and regulatory uncer regarding disclosure and fees.

The recent deals weren't c Schwab & Co. paid $365 millio State Street Corp.'s trust assets. ford C. Bernstein & Co. analysts r that works out to 3.2% of assets management, way over the indu median 1.9% and higher than the Schwab paid for U.S. Trust in 20

The Neuberger Berman deal fetc premium, too. Lehman paid about of $63.7 billion in assets, making th one of the most expensive ever. $120 million in restricted stock will ward retaining key partners, who have a bigger channel through wh sell their wares. Lehman, in turn, sifies beyond its bond and tr strengths, which accounted for 6 revenues in the second quarter. ers are savvier and more careful t says Robert Matza, Neuberger Ber chief operating officer. Adds ind consultant Kevin P. Quirk, of Quirk & Acito: "These days, acquis are smarter; it's about retaining th ture and talent of the key people."

Financial services has been the sector for dealmaking since 2000. S

A FLURRY OF DEALS

Mergers in financial services have ticked up lately as big players rush to consolidate:

	JULY 22	JULY 18	JUNE 25
BUYER	Lehman Brothers	Federated Investors	Charles
TARGET	Neuberger Berman	Riggs National	State S
SPECIALTY	MUTUAL FUNDS	MUTUAL FUNDS	ASSET MA
	$2.63 billion	Not disclosed	$365

ar, there have been $35 billion
actions, but Lehman's is the first
eal, according to Eric C. Weber,
iltant at Freeman & Co., a New
ivestment bank specializing in fi-
services. Most of the activity,
, will center on boutique firms. "I
e a lot of other deals this size in
eline," says Weber.
may well be so. For starters,
3 of the top 50 asset managers
re plays. Just seven are public
ies, including San Mateo (Calif.)-
Franklin Resources Inc. and Bal-
s T. Rowe Price Group Inc. Oth-
ch as State Street and Eaton
Corp., vociferously proclaim their
idence. "I'm not sure that many
n feel the pressure to sell," says
Lee, a KBW analyst.
the flurry of activity has ob-
wondering who's next. Future
ikely will be struck to broaden
mix or pick up cheap assets at
d firms. Even though it lost a
key managers, the once white-hot
still manages $150 billion in as-
making it an attractive target.
rregional banks such as Wa-
Bank One, and Bank of America
prime likely suitors. "They have
ance sheets, and they can pay
miums," says Bob Stein, chair-
global financial services at Ernst
ng. Speculation is also swirling
surance and other financial con-
ates could spin off their asset-
ment arms. UBS's Schorr says
lots of potential, since 39 of the
asset managers are owned by
yers. According to industry in-
New York insurer Marsh &
nan Cos. might sell Putnam In-
nts. The fund family had out-
f $15.7 billion last year and $5.6
so far in 2003, making it one of
st challenged in the industry. A
woman for Marsh & McLennan
ere are no plans to sell Putnam.
for the right price, just about
—even if they're not officially
e—could cave. "I haven't been
the right to just say no," says
ted's Donahue, who sold his com-
nce before to Aetna Inc. in 1982
6 million. (He bought it back 14
ater.) If the market keeps it up,
rs like him may see some more
-refuse offers coming their way.
ura Der Hovanesian in New York

JUNE 6	
xpress	Eaton Vance
dle	Parametric Portfolio
EMENT	ASSET MANAGEMENT
ion	$28 million

THE MOUSE ROARING AT FANNIE AND FREDDIE

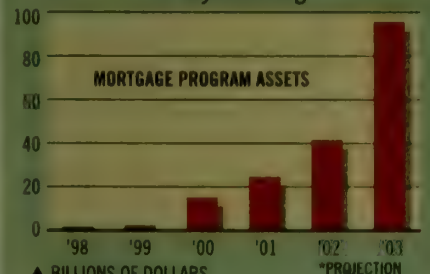
A small Chicago rival is horning in on their territory

There's a new kid on the block, and the big boys don't like it one bit. Six years ago, Alex J. Pollock, a puckish philosophy teacher-turned-banker, launched a program to buy mortgages from banks at his little-known Federal Home Loan Bank of Chicago. The move took him far beyond his bank's brief to provide credit to small banks, thrifts, and insurers—and put him on a collision course with Fannie Mae and Freddie Mac, the titans of the mortgage business.

So far, Pollock's brainchild has not only avoided getting crushed, it has thrived. With growing numbers of banks and thrifts selling their mortgages to Pollock's Mortgage Partnership Finance program, to the chagrin of Fannie and Freddie, the value of its outstanding loans jumped 130% in just 12 months, to $68.8 billion, as of June 30. Already, that equals 8.5% of the $812.5 billion in mortgage debt that Fannie Mae owns. After beating back repeated attempts in Washington to cap or quash his program, Pollock, the chief executive of the Chicago bank since 1991, sees its growth as a sharp slap at his outsize rivals. "We are growing...three or four times faster than Fannie Mae or Freddie Mac," he says. "We are a very real alternative."

BUILDING FAST

The mortgage-buying program at the Chicago Federal Home Loan Bank is skyrocketing



Data: Chicago Federal Home Loan Bank, *BusinessWeek*

An alternative is just what many housing experts—and key figures on Capitol Hill—have long wanted. Fannie and Freddie have grown enormous—helped by the country's homeownership boom, but also by government charters (which Pollock's bank also has) enabling them to borrow money at lower rates, pay fewer taxes, and escape many corporate-reporting requirements.

A long-simmering debate over whether Fannie and Freddie are too big and take on too much risk exploded in June, when a still-unfolding accounting scandal cost the jobs of Freddie Mac's three top executives. Fannie's and Freddie's toughest critics say the best long-term answer would be to level the playing field by cutting their government links, or at least put them under a tougher regulator—not just encourage a rival to horn in on their market. But for now, House capital markets subcommittee Chairman Richard H. Baker (R-La.) says he wouldn't mind if Pollock's program grew. The home-loan-bank system (Chicago is one of 12 regional banks) "is like the teenager Fannie and Freddie," he says. "I don't see any urgency to constrain [them]."

Such high-level support alarms the program's many foes. And it's giving Pollock, who boasts master's degrees in philosophy from the University of Chicago and in international relations from Princeton University, an advanced course in political hardball. Opponents accuse him of mission creep. Gregory Baer, a former Treasury official and a lawyer who does legal work for Fannie and other critics, says Congress has never authorized home-loan banks to buy mortgages. And so, it "has never established the safety-and-soundness protections" for the program as it did for Fannie and Freddie, he says.

Fannie Mae—famous for its deft lobbying on the Hill and its generous donations to friendly legislators—has had Pollock's mortgage program in its sights almost from the start. In early 2000, when the program counted only $1.8 bil-

lion in assets, officials at Fannie Mae fretted that this tiny challenge posed an "immediate threat" to their business. In an in-house memo, they spelled out a bare-knuckled strategy whose "endgame" was to convince the federal home-loan banks "that our business is NOT a business in which they want to compete." Fannie aimed "to maximize our business volume at the FHLB's expense with a minimum impact on our expected business margins and fees," the memo said. As part of this effort, Fannie supported a campaign to cap the value of mortgages the Chicago bank could buy.

That campaign failed, but Fannie has never given up. For example, it funded a report released in June by Sheila C. Bair, a former Treasury official and now a professor of financial regulatory policy at the University of Massachusetts' Eugene M. Isenberg School of Management. In the report, titled *Is the Federal Home Loan Bank System Forsaking Its Roots?*, Bair argues that the home-loan-bank system is taking risks for which it is not prepared. And on July 21, at a Senate hearing, Fannie officials lambasted Pollock's program in a printed handout, charging that it serves mainly big banks and overstates Fannie and Freddie's importance to the housing market. They even faulted it for its exemption from federal income taxes, which Fannie and Freddie pay. All three, though, are exempt from state and local income taxes.

Even some of Pollock's colleagues are uneasy about his fast-growing program. Federal Home Loan Bank of Atlanta President and CEO Raymond R. Christman has set up a program similar to Chicago's. But he worries that Pollock's ambitions are too big for a system that started during the Depression as a sort of Federal Reserve for the thrifts and small banks that joined up as members. The main job of the home-loan banks, he says, is to provide credit to member banks; competing directly with Fannie and Freddie "overlooks what I believe is our core mission."

Pollock dismisses such arguments. He says the program has stood up to legal challenges and does exactly what the home-loan banks were organized to do. Insists Pollock: "Every dollar of the program's funding directly helps an American family finance a home."

Supporters also point to an important difference between the Chicago program and those at Fannie and Freddie: It disperses much of the mortgage risk to the hundreds of banks that participate, while its two rivals concentrate the risk with themselves. When local banks sell their loans to Pollock's program, they stay on the hook if borrowers default. To compensate lenders for keeping that credit risk, the program pays them a monthly fee. By contrast, Fannie and Freddie take the risk off the lenders for a fee. Because the Chicago program's lenders are stuck with the risk, they may be more careful. Only 0.1% program's loans are deli vs. 0.56% for Fannie M 0.8% for Freddie Mac.

For the Chicago ban mortgage program is a bi it center. It makes mor the interest homeowners their mortgages minus terest it pays on low-rate that it sells to institutio vestors and foreign ba can borrow at lower rat other companies becau vestors believe the gover will make good on the l the home-loan bank s faces a crunch. Last ye program generated $196 lion, nearly half of the interest income.

But Pollock is just g started. Under an arrang begun in March, Chicago One Corp. is packagir mortgages his bank bu much the same way as and Freddie, so that he sell them as securities home-loan-bank system's bers. Fannie Mae oppose plan, bolstered by suppor the Congressional Black keen advocates for Fann Freddie because of their making housing more affo The Bank One deal co construed as a first step selling such securities public, as Fannie and F do—although Pollock there are no plans to do

His program may soon get a big boost from Washington. By ye the home-loan-bank system's reg the Federal Housing Finance Bo expected to allow the program loans from member banks and that originated with nonmember cial outfits—an ambiguous area rules now. Even rising interest could drive up business for th gram, and for its rivals, as banks ble to sell off low-rate mortgag fore rates go higher. Clearly, as P program gets bigger, this fight w nastier.

By Joseph Weber and Ann T Palmer in Chicago, with Amy I in Washington

A BETTER MOUSETRAP?

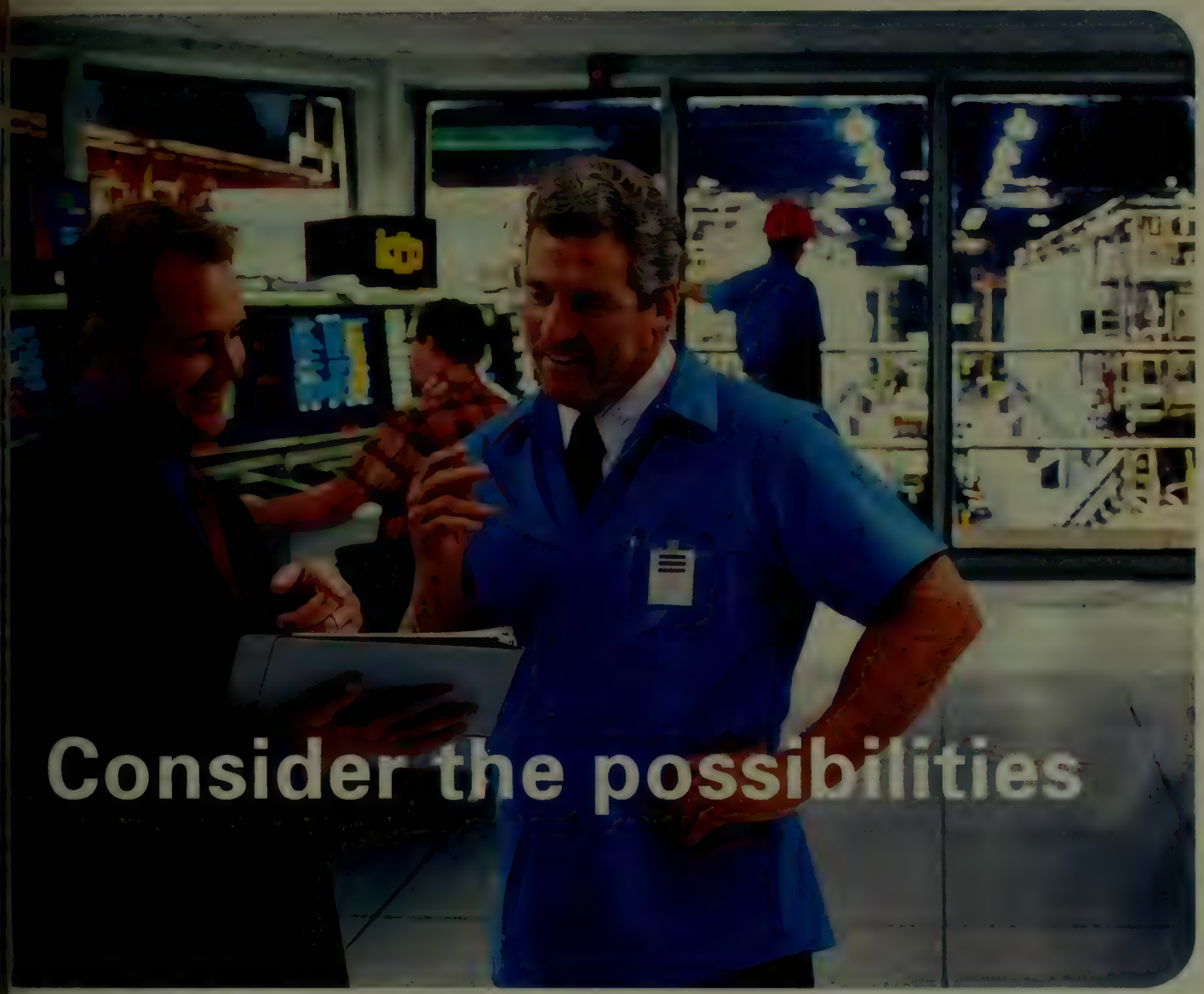
The Chicago Federal Home Loan Bank operates similarly to Fannie Mae and Freddie Mac, but there are key differences

- It doesn't assume the risk that a homeowner will default on a mortgage, leaving that with local banks or insurers
- It can't sell mortgage-backed securities to investors at large, only to member banks

Data: Chicago Federal Home Loan Bank

NEW KID ON THE BLOCK

"We are a very real alternative" to Fannie Freddie, Pollock says



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COMMENTARY

By Tom Lowry

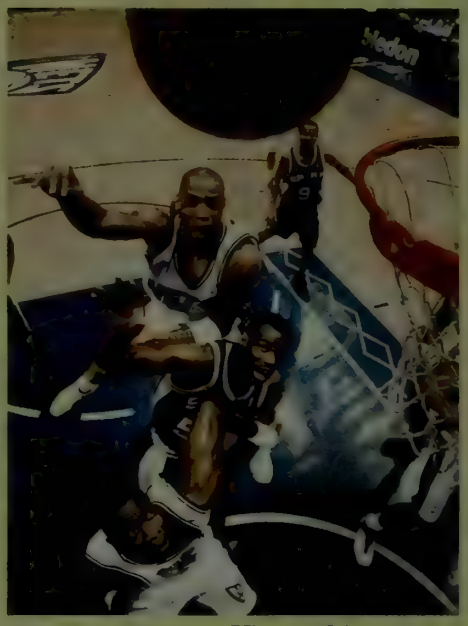
BROADCAST RIGHTS MAY HEAD BACK TO EARTH

It has become a ritual: Television executives whine about the high price of sports programming and then turn around and make outrageously high bids to win broadcasting rights. The worst-kept secret in the media business is that virtually no one makes a profit on pro sports.

But it appears that the TV sports bubble, like the once-bloated stock market, is finally headed for a correction. Losses on sports contracts from 2001 thru 2006 could exceed $6 billion, estimates Morgan Stanley. Ratings are down (in some cases way down), shareholders are applying pressure on companies that own TV properties, and Congress has even stuck its nose into the high cost of America's national pastimes.

The upshot is that, after years of ego-driven bidding frenzies, more and more executives believe it's time to just say no when it comes to upping the ante on sports rights. As a result, the next round of sports deals could produce no prices hikes, or possibly even smaller deals. That would rock the leagues. If the gusher of TV revenue subsides, team owners will be forced to find new revenue streams, such as subscription services and overseas distribution deals. More importantly, they will have to redouble efforts to hold down soaring player salaries. "My hope is that the marketplace would come to its senses," says NBC Sports President Ken Schanzer.

It's about time. The old economic model for TV sports is dated. The strategy among execs used to be that if they couldn't recoup their investment in broadcast contracts, they could always use the games' huge audiences as a one-of-a-kind opportunity to promote their prime-time lineups and other network programming. But today, the people watching sports are mostly men, and the people watching prime-time shows are mostly women. "Begrudgingly, executives are beginning to realize that sports is not a loss leader anymore, either," says Richard A. Bilotti, a media analyst at Morgan Stanley. He estimates that sports losses wipe out about 40% of all profits from prime-time programs.



2003 NBA FINALS: *Viewership was down 37% from '02 and 66% from '98*

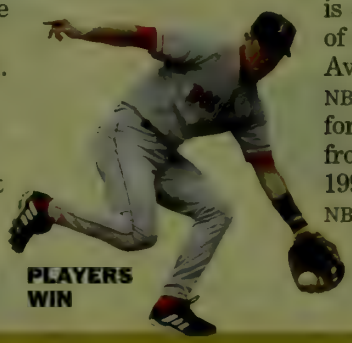
The once-massive sports audience is shrinking—largely because of new cable-channel choices. Average viewership for the NBA Finals this year on ABC, for example, was down 37% from last year and 66% from 1998, when they were on NBC, according to Nielsen Media Research. Similarly, viewership for Major League Baseball's All-Star Game on Fox on July 15 was do 5% from last year and 38% from Bilotti projects Fox will lose $54 lion this season on its $2.5 billion year baseball deal. "These prices go up like this much longer," say Rupert Murdoch, chairman of Fo parent News Corp. "Broadcaster can't make money on sports any longer. I know we couldn't. The a ence is too fragmented."

That's a candid acknowledgme from the man other media execs helped land sports in its current mess. They blame Murdoch for ing the first big breath into the ble in 1993, when Fox snatched NFL contract away from CBS wit bid that was $400 million richer. These days, it looks as if Murdo has gotten religion after having take a nearly $1 billion write-do February, 2002, on losses associa with his current sports deals.

The leagues are all exploring t possibility of striking deals to bro cast more games on cable, but th ble industry is under fire in Wash ton. The average cable bill went 8% last year, largely because of t high cost of sports, and Senate C merce Committee Chairman John Cain (R-Ariz.) is investigating rat

If execs do take a harder look sports-broadcast deals, one thing certain: Team owners will have t evaluate what they pay their play ers—the big winners in recent ye The New York Mets' annual payr for instance, rose from $13 millio $87 million from 1995 to 2001. Th industry is none too sympathetic. have no concerns that these guys still be able to pay their mortgag says one exec. Of course, it was t networks that built the players' r sions in the first place.

With Ronald Grover in Los An



PLAYERS WIN

SPORTS: A BIG LOSER

TV execs are becoming less tolerant of the red ink flowing from thei pricey sports programming. The damage expected in coming years:

	ABC	CBS	ESPN*	FOX	FX	NBC	TURN
Estimated Losses 2000-2006	$1.1 Billion	1.2 Billion	0.9 Billion	1.3 Billion**	0.3 Billion	0.4 Billion	1.4

*Includes ESPN2 **$359 million when adjusted for reserve Data: Morga

roducing
jh performance technology that's also od
the environment.

Now you can hug corners while you hug Mother Nature.

revolutionary new Hybrid Synergy Drive® combines a gasoline engine with a powerful electric motor that never needs to be in. The result? Super-efficient, super-charged performance. This groundbreaking yet affordable technology hits the roads this fall xt generation Prius. Prius achieves nearly 2.5 times the average fuel efficiency of conventional vehicles and close to 90% fewer rming emissions – all while accelerating from 0 to 60 mph in 20% less time than its competitor.*

Prius, Hybrid Synergy Drive will be available in more and more Toyota products – including SUVs.

brid Synergy Drive, we're helping save the planet. Faster.

com/tomorrow

er's testing for 2004 est. city & combined mpg. 0-60 mph for comparison only. Obtained with prototype vehicle by professional using special procedures. Do not attempt. ©2003

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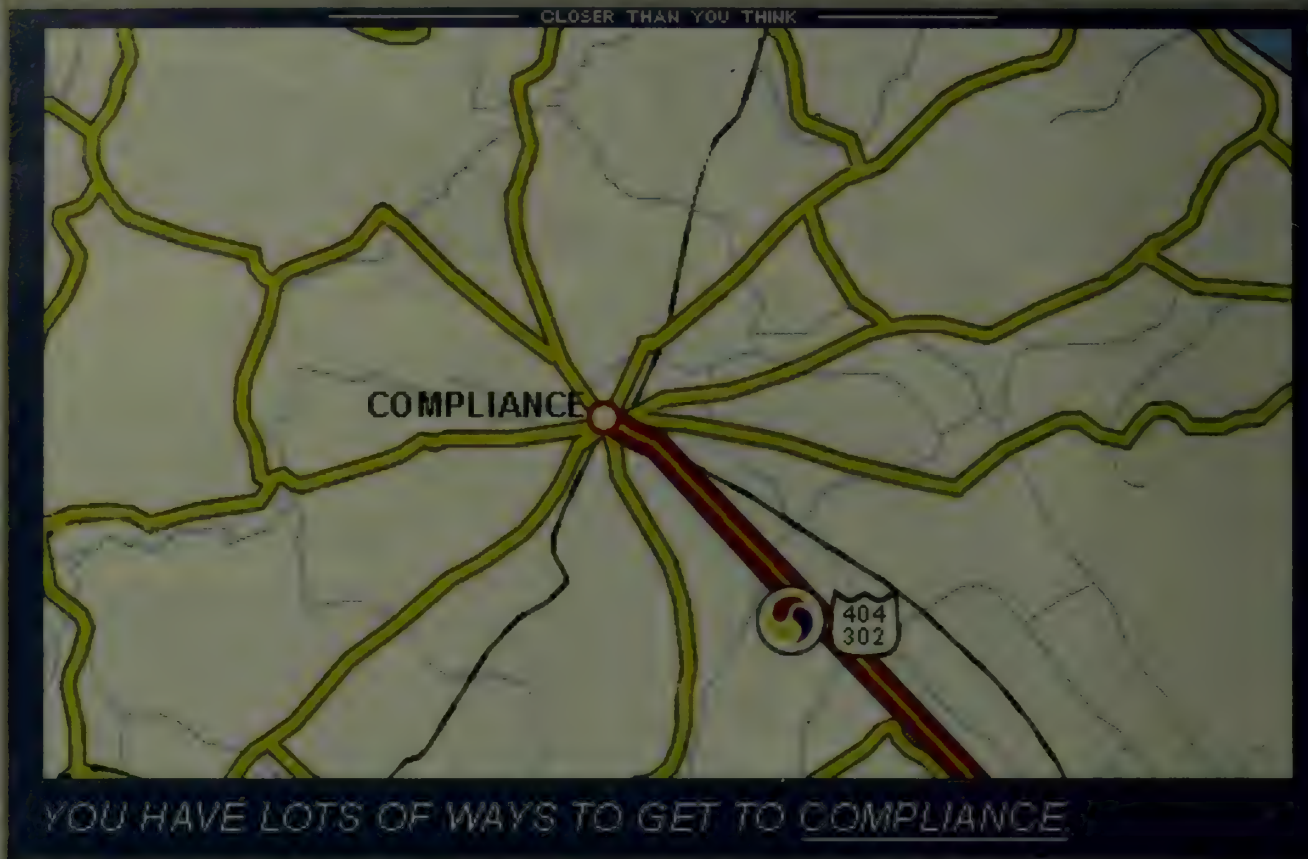

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THE STAT

66

ICE-EARNINGS ratio, rojected 2003 s, for Internet stocks. nore than triple the p-e 19 for the Standard & 500.

ata: Bridgewater Associates

STING

S YOUR NEY

rade's new efund policy

kerage arm of **le Group** recently ced a startling policy: g its clients money he refunds will come e annual 12-(b)1 and lder service fees e collects from fund ies in its mutual fund arket. Now an e client who has l $500,000 in a fund .40% service fee will **$1,000** each year, fee collected from the Trade says its cost of funds has dropped, assing those savings ents. Now maybe okers will follow suit.

EDUCATION

Pay Now, Save Big

YOU MAY BE CONVINCED your toddler is Ivy League material. But how will you pay the $250,000 four-year tuition tab for college?

It may be easier than it sounds. The **Independent 529 Plan**—set to debut on Sept. 3—lets parents (and others) lock in today's tuition rates at more than 200 private colleges, including Princeton, Notre Dame, and Syracuse. It works like this: Suppose you contribute $10,000. Today, that covers 35% of one year's current tuition bill at Princeton or 40% at Syracuse. When your child enrolls, you've got 35% or 40% of one year's tuition paid at those schools. You can make further contributions—the maximum is about $135,000. As a bonus, the plan offers discounts of at least half a percentage point off current tuition; the deals vary by college. Like other 529s, the money invested grows taxfree as long as it's used for tuition.

What if your child isn't admitted? You'll get a refund, plus or minus two percentage points each year, depending on how the plan's investments fared. To enroll: www.independent529plan.org or 888 718-7878. *Anne Tergesen*

ELECTRONICS

INSTANT BOOM BOX

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operated stereo speakers built in to one side. Plug it into the headphone jack of your audio player or laptop computer, and you've got a boom box. It's $30 at Amazon.com.

MUTUAL FUNDS

CREEPING COSTS

Expense ratios for equity mutual funds take an average of 1.56% of assets per year—but that doesn't include trading costs. A study by **Savant Capital Management**, a Rockford (Ill.) financial-planning firm, looked at turnover ratios, the percentage of a fund's portfolio that trades in a year. It found that a 100% turnover will incur 0.15% to 0.72% in trading costs, depending on the market cap of the companies in the fund.

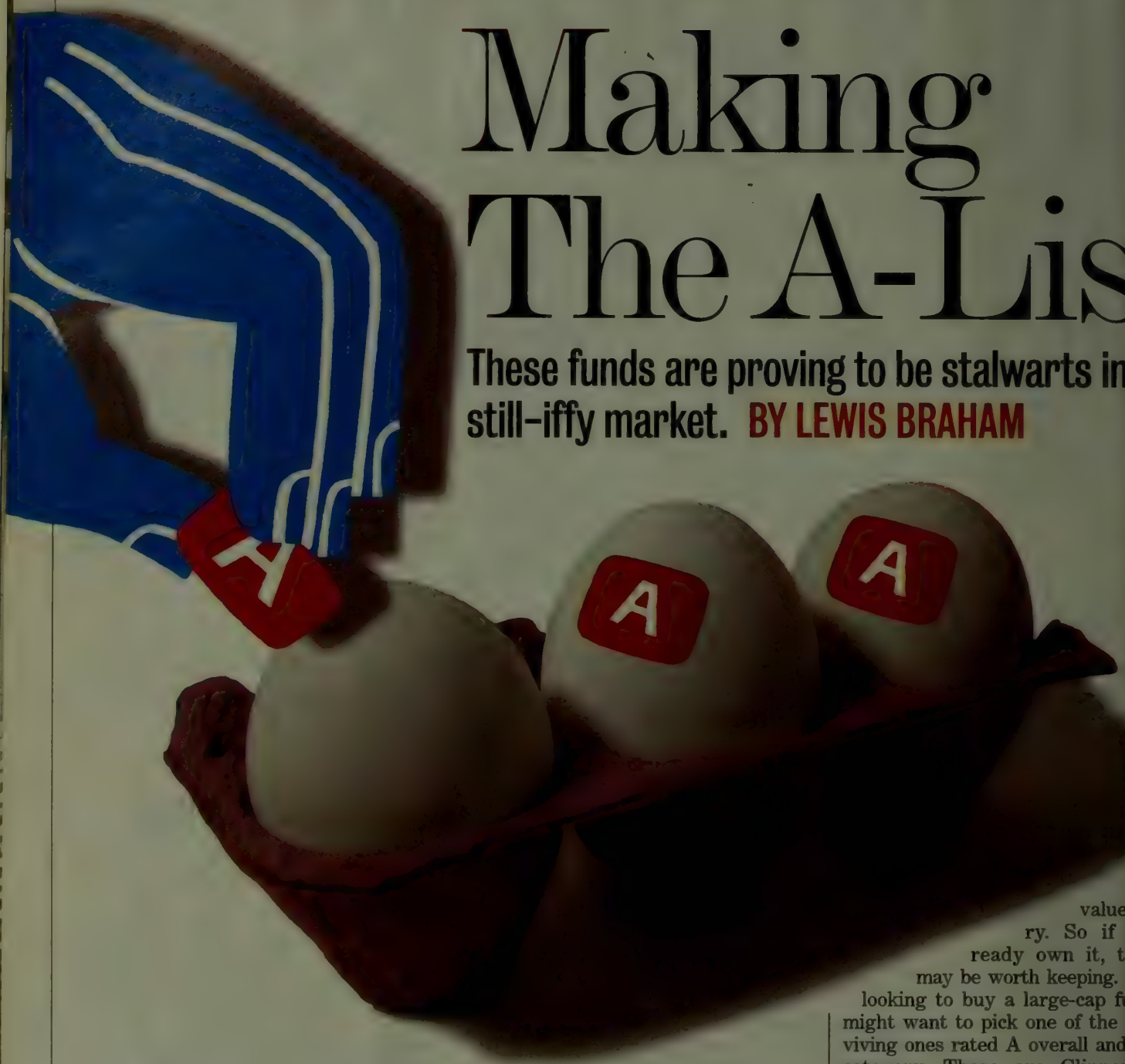
Annual Trading Costs as Percent of Fund Assets

Turnover	Small-Cap	Mid-Cap	Large-Cap
10%	0.07%	0.03%	0.01%
100	0.72	0.29	0.15
200	1.43	0.58	0.30

Data: Savant Capital Management

Making The A-Lis

These funds are proving to be stalwarts in still-iffy market. BY LEWIS BRAHAM



HOW the fund world has changed. In the beginning of 2000, 56 large-cap funds held an A rating in *BusinessWeek*'s Mutual-Fund Scoreboard. Halfway into 2003, only five rank that highly when measured against all stock funds. In place of such well-known behemoths as Dodge & Cox Stock, Longleaf Partners, and all the Janus funds, you now find Buffalo Small Cap, Value Line Emerging Opportunities, and other small-cap offerings that simply held up better during the stock market's slide.

Does that mean you should replace your large-cap funds with small caps? No. The scoreboard, which is updated monthly at BusinessWeek Online, ranks all stock funds from A through F based on their five-year returns, adjusted for downside risk. It also assigns category ratings, comparing a fund's five-year risk-adjusted returns against its peers with the same investment style. Without considering the category grade, you're seeing only half the picture.

Take Dodge & Cox Stock. Even though it rates a B+ against all stock funds, it's still an A in the large-cap value
ry. So if
ready own it, th
may be worth keeping. I
looking to buy a large-cap fu
might want to pick one of the fi
viving ones rated A overall and
category. These are Clipper
Thompson Plumb Growth, MFS St
Value, Parnassus Income Equi
Smith Barney Aggressive Grow

That said, it's worthwhile to c
newcomers to the A-list, espec
they also have an A category
One such fund is Aegis Value, wh
been trouncing its small-cap valu
since its inception in May, 1998. M
Scott Barbee's strict buy-sell di
has enabled him to deliver a 15.7
year annualized return. He buys
of tiny companies, with market c
than $1 billion, which trade belo
book values or the value of their
If he can't find what he's looking
holds cash. That strategy differ

lue managers, who are often ful-ted, buying stocks that are less ve than the market average, even they may not be intrinsically

ee is none too pleased with the ts for stocks now. Since the ral-n this April, "valuations have ay, way up," he says. Because dearth of cheap stocks, he has his cash levels from 13% in o 25%. He's convinced the mar-ains will be transient. "Unless nomy turns around in a strong way, investors and the market in general are cooked," he says.

GROWING OPTIMISM

Ironically, while many large-cap funds have fallen off the A-list, some A-rated managers who buy larger stocks have grown optimistic. Bill Nygren of Oakmark Select Fund, rated A overall and in the mid-cap value category, has been buying giant companies such as media powerhouse AOL Time Warner. "In the market peak of 2000, small stocks were much cheaper than large," he says. "But there are now values across the capitalization spectrum." Nygren thinks AOL is selling at "insane valuation levels, less than the old Time Warner company [a subsidiary of AOL] is worth."

Managers of growth-stock funds, which suffered more than value funds in the bear market, also think the rally can continue. Given how their favorite sectors, technology and health care, have rallied more than others, 11 growth funds have joined the A list this year, nine of them small-cap growth funds. "I've been able to find many good

New A-Rated Funds

ssWeek rates mutual funds based on their risk-adjusted returns over a five-year period. Funds get an overall rating (A to F) based v they compare with all other equity funds. The following have earned A ratings since we last published the A-list in January. Those e also rated A in their categories are noted by the dagger (†). All fund ratings are updated monthly at BusinessWeek Online.

FUND	CATEGORY	AVERAGE ANNUAL TOTAL RETURN (%)*	FUND	CATEGORY	AVERAGE ANNUAL TOTAL RETURN (%)*
MRO Mid Cap N	Mid-cap Blend	9.2	MFS Strategic Value A†	Large-cap Value	12.0
MRO Veredus Aggr. Gr. N	Small-cap Growth	11.6	MainStay Equity Inc. B	Mid-cap Value	8.2
pportunities I A†	Small-cap Growth	15.7	Matthews China	Pacific/Asia ex-Japan	9.0
Value†	Small-cap Value	15.8	Merrill Lynch Nat. Res. A	Natural Resources	9.7
nk	Small-cap Blend	13.7	Munder Healthcare B	Health	8.3
Rock US Opport. B†	Small-cap Growth	15.3	Nuveen NWQ Multi Cap-Val. R	All Cap	9.1
Partners S-C Value II†	Small-cap Value	13.6	OCM Gold	Precious Metals	13.5
o Small Cap†	Small-cap Blend	16.8	Oakmark Select I†	Mid-cap Value	13.1
Realty†	Real Estate	12.2	Oberweis Micro Cap	Small-cap Growth	11.3
& Steers Eq. Inc C	Real Estate	8.2	Oppenheimer Dev. Mkts. A	Divers. Emerg. Mkts.	10.0
onwealth New Zealand†	Foreign	11.9	Perkins Discovery†	Small-cap Growth	14.3
ld	Small-cap Value	8.5	Perritt Micro Cap Opport.	Small-cap Growth	8.9
s Prem. Emerg. Mkts. A	Divers. Emerg. Mkts.	10.2	Phoenix-Duff & Phelps R.E. A	Real Estate	9.6
s Prem. Greater China A	Pacific/Asia ex-Japan	10.6	RS Diversified Growth	Small-cap Growth	8.5
us Emer. Mkts. Gr	Divers. Emerg. Mkts.	11.0	RS Partners	Small-cap Value	9.0
ld Sel. Banking & Fin. A†	Financial	9.3	Rockland Small Cap Gr.	Small-cap Growth	10.2
en Prec. Metals Hldgs A	Precious Metals	14.3	Royce Special Equity	Small-cap Value	9.9
ior Mid Cap Value	Mid-cap Value	9.1	Rydex BioTechnology Inv.	Health	14.0
mmon Stock	Mid-cap Value	8.4	Santa Barbara Bender Gr. Y	Mid-cap Growth	8.6
y Sel. Biotech.	Health	10.0	Scudder Health Care S	Health	9.1
y Sel. Med. Sys. & Eqp.	Health	16.5	Security Capital Euro. R.E.	Real Estate	8.3
y Southeast Asia	Pacific/Asia ex-Japan	8.9	Security Capital U.S. R.E.†	Real Estate	8.9
hird Micro Cap Value†	Small-cap Value	12.7	Security Mid Cap Gr. A	Mid-cap Growth	9.6
merican R.E. Secs. Y	Real Estate	8.4	State St. Res. Aurora A	Small-cap Value	9.6
ource Monogram Spec. Eq.	Small-cap Blend	8.2	State St. Res. Glbl. Res. A	Natural Resources	9.9
Emerging Countries III†	Divers. Emerg. Mkts.	11.5	Stratton Monthly Div. REIT	Real Estate	8.4
Wwood. Mighty Mites AAA	Small-cap Blend	12.7	TCW Galileo Asia Pac. Eq. I	Pacific/Asia ex-Japan	10.8
and Value	Small-cap Value	9.7	Tocqueville Gold†	Precious Metals	21.0
ussia A†	Divers. Emerg. Mkts.	24.0	Turner Micro Cap Growth†	Small-cap Growth	31.2
s MSCI Malaysia Index	Pacific/Asia ex-Japan	13.8	U.S. Glbl. Accolade Reg. E. Eur.†	Europe	10.8
bal Nat. Res. A	Natural Resources	10.8	Wells Fargo Mont. Emrg. Mkt. Foc.†	Divers. Emerg. Mkts.	11.3
Newport Grtr China A	Pacific/Asia ex-Japan	10.9	Westport R	Mid-cap Blend	8.7
Small Cap Z	Small-cap Value	8.2	Westport Select Cap I	Small-cap Blend	11.5

s through June 30. Appreciation plus reinvestment of dividends and capital gains before taxes

Data: Standard & Poor's

small companies that are able to do well, regardless of how the economy is doing," says manager Frank Sustersic of Turner Micro-Cap Growth, which has a pair of A ratings—and is closed to new investors. Sustersic likes generic drugmaker Able Laboratories, which is ready to move in as many name-brand drugs come off patent.

Some of the most promising funds invest in out-of-favor sectors. Consider that only six emerging-market funds have managed to get A's overall, and you realize that manager Arjun Divecha of GMO Emerging Countries III Fund must have figured out something that has eluded his peers. What's his secret? "We focus on the countries we invest in more than picking stocks," he says.

Before Divecha invests in a country, he wants to make sure it isn't vulnerable to an economic crisis. He likes to see a cheap currency and a positive trade balance. Now, Divecha favors Brazil and Thailand, which have recovering economies and cheap stocks.

More than 40 funds on the A list are in hot sectors such as gold and real estate. But most of them may just be riding a positive trend in their sector. Only a few also have A category ratings, including Security Capital U.S. Real Estate and Tocqueville Gold.

Manager Ken Statz of Security Capital's fund thinks real estate stocks could deliver 10% or 11% returns going forward, although he admits they're not as cheap as they once were. "In 2000, real estate stocks traded at a 20% to 30% discount to the value of their underlying real estate," he says. "Today they trade at 5% to 10% premiums." His team of 25 analysts and co-managers scrutinize property values to find bargains, and steer clear of volatile stocks.

Gold stocks and bullion tend to perform best when the market is in panic mode, and John Hathaway of Toqueville Gold believes the bad times are far from over. "We're in a bear-market trend for stocks and bonds," he says. "The analogy would be from 1968 to 1982, when gold was the top-performing asset class and rose from $35 an ounce to $800." During that period, inflation soared, and so did gold and other hard assets. Hathaway thinks there'll be a different tri time: the credit bubble. Americ rowed so much during the 199 terest rates fell that now there' pacity in the economy, he says. V bubble bursts, investors will flee

Even Hathaway doesn't rec putting more than 10% of you into a gold fund as a form of fin surance. The funds can be volati gold funds with A ratings over Hathaway's receives an A in the

Despite the recent runup stocks, only two tech funds re overall and category ratings: formation Technology and Kin ternet. Given how terrible tech formed in the last three year understandable. But investors take note of them. After all, thr ago there was only one small-c on the list. Now look how man

BusinessWeek online

Our Mutual Fund Scoreboard can be found at bwnt.businessweek.com/mutual_

Q&A

Seeking Out Stocks That Surprise

Anthony Weber is back in the saddle again. After two brutal years, the manager of the A-rated ABN AMRO/Veredus Aggressive Growth Fund is once again beating the market and his peers in the small-cap growth fund category. A Kentuckian, the 44-year-old is a horse fanatic, so he named the fund Veredus, Latin for "swift horse," to reflect his rapid-fire trading style. But Weber isn't gambling with investors' assets. His $435 million fund has delivered an 11.6% five-year annualized return, compared with –1.6% for the Standard & Poor's 500-stock index and 0.8% for the average small-cap growth fund. Personal Finance Editor Lewis Braham recently spoke with Weber.

Q. How would you describe the fund's investment strategy?

A. We feel what drives stock price movements, especially for small-cap growth stocks, are earnings surprises and subsequent analyst estimate revisions. We screen for stocks that are meeting or exceeding analysts' earnings expectations for at least two quarters in a row and then look for those that have had the greatest upward estimate revisions. If our investment team believes the stock will continue to exceed expectations, we buy it. Once the Street's analysts catch up to our estimates, we sell.

Q. What have you been buying lately?

A. Home builders and energy stocks. One of our builders, Homes, has beaten the Street's expectations for 26 conse quarters. The builders have several things going for them. there's a large market for new homes and huge barriers fo competitors to break into the industry. There's no foreign competition. There's no technology to supplant a builder. demographics are phenomenal. We've had a tremendous of immigrants. That is driving first-time home buying.

In the energy sector, we like gas and oil exploration com Patterson-UTI Energy, Pride International, and Ultra Petro think we are in the midst of a potential energy crisis. Right U.S. gas reserves stand at a full 25% below last year's leve Meanwhile, industrial energy demand is down 50% from l year. What happens when that demand comes back? We have an energy shock like we did in the 1970s.

Q. What about technology?

A. In the 1990s with tech stocks, all boats rose. That's not be the case this decade. We've got 15% to 16% tech right and there's no real theme. It's very stock-specific.

Q. How do you control risk?

A. An initial position in a company is typically only 1% or 2% portfolio, and we don't let it grow beyond 5%. We use a lot technical analysis—relative strength, volume, money flows give us signals as to when to sell. If a company has no good to miss an earnings estimate, it's out. There are far more los small-cap stocks than in large. That's why the portfolio's tur ratio is 150% to 200%. We trade to avoid land mines.

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BEST-IN-CLASS CARGO SPACE	STANDARD	N/A	N/A	N/A
BEST-IN-CLASS TOWING†	STANDARD	N/A	N/A	N/A
CHOICE OF TWO V6 ENGINES	AVAILABLE	N/A	N/A	N/A
POWER LIFTGATE WITH VO-WAY OBSTACLE DETECTION	AVAILABLE	N/A	AVAILABLE	N/A
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STAYING IN SHAPE: Walker logs 4,000 miles a year riding to and from work

Breaking Away From Rush Hour

Bike commuting is healthy—and dirt-cheap. BY JOHN CAREY

THE SLOWER THE TRAFFIC is on his commute to and from Akron, Ohio, the happier Arthur Wickersham is. That's because the 60-year-old chief executive of Community Support Services, a nonprofit mental health organization, is not stuck in the gridlock: He's pedaling by it on his bicycle. Wickersham rides 10 to 12 miles each way, depending on his route, taking him about 45 minutes[-] he arrives home in St[-] at the same time as ca[-] staffers who live in h[-] borhood. "Each day o[-] cycle is an adventure[-] ersham says. "And it's[-] and nonpolluting to bo[-]

I share Wickersha[-] Over the past decade, [-] cycled more than 30,0[-] on my 10-mile trip to [-] work in Washingto[-] passing the stalled traf[-] 66 as I zip along on a[-] bike path. More than [-] Americans commute t[-] according to U[-] sus data. I[-] cities, such a[-] Calif., the [-] tops 20%.

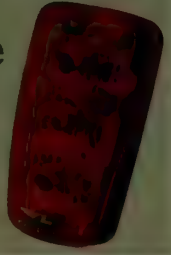
Still, "tho[-] pretty pathet[-] bers for a nat[-] should be smarter and[-] says Andy Clarke, dir[-] state and local advocacy[-] League of American Bi[-] Coaxing more Americ[-] traveling by bike cou[-] liorate a host of ills—fr[-] lock and air pollution[-] growing epidemic of ob[-]

One big objection [-] bike commuting eats [-] much time. Not so. "It [-] take much longer on t[-] than it would to drive[-] Doug Walker, 52, CEO of[-] software company in [-] who racks up nearly [-] miles a year riding to and from work. He started bi[-] muting 13 years ago to stay in shape. "I just fall[-] bed, eat something, ride to work, then shower and s[-] the office," says Walker. "It's a huge time-saver."

I've discovered plenty of other pluses. Next to the[-] driving (parking alone is $220 a month in my buildi[-] car costs would top $120 per month) or public transp[-] ($76 per month on the Metro subway system), my c[-] is dirt-cheap. There really are no costs, save for a tu[-]

Cycling Supplies

VistaLite Total Eclipse ($20; vistalite.com). Bright light is visible up to 2 miles away. Runs 200 hours on two AAA batteries.



Third Eye Eyeglass Mirror ($8.49; www.3rd-eye.com). Important for keeping you aware of what's coming up from behind.

REI Explorer Panniers ($70; rei.com). Bags for toting around clothes and other essentials.

($15 to $30) every six months or so, once you've got
e and a few hundred dollars' worth of gear.
community benefits, too, from having fewer cars on
d. That's why there's a strong push in Congress this
add more bike-friendly measures to a major funding
t would reauthorize the current highway law. The
es would boost funding for bike routes and offer sub-
o bike commuters.
an spend for a fancy bike, but just about any one will
le a trusty 28-year-old Raleigh 10-speed from my col-
s. Software CEO Walker uses an expensive mountain
get to work—then for appointments in town, hops on
er city model that doesn't make him nervous when he
on the street. Veterinary surgeon David Nelson, 51,
wife Katherine get to their jobs at Texas A&M Uni-
together on a tandem.

FIRST

er steed you choose, your commute will be safer
ier if you also have these essentials and accessories:
eyeglass- or helmet-mounted mirror for seeing what's
from behind: sturdy Kevlar-belted tires to minimize
us pump, tire irons, and spare tube); fenders and
olored waterproof vest or jacket to keep you cleaner,
d more visible in the rain; headlight and flashing tail-
r evenings; and a rack and panniers to carry clothes,
and laptop. You should read John Forester's classic
ffective Cycling, to learn how to safely cope with traf-
instance, always assume that drivers can't see you. So
d to wear colorful clothes and outfit yourself with
f reflectors and lights. Obey the same rules as any
hicle on the road. Take up an entire lane when nec-
nd don't weave in and out of traffic.
question every bike commuter hears is: Don't you get
Well, yes. For many commuters, shower facilities at
a nearby health club are essential. But it's possible
ithout. During the fall, winter, and spring, I simply
ers before getting hot. In the summer, I rely on tow-
clean clothes that I bring with me in my panniers.
ling to work takes a bit of planning. Congressional
h Service analyst Baird Webel, 34, has so many of
in his office that "when I have a formal engagement
weekend, I have to think about how to get clothes
he says. It also helps to have good transportation al-
es for getting home or around town during the day.
out when it snows, shifting to the Metro. Others
on Monday morning and leave their cars at the of-
l Friday evening. Some areas, such as metropolitan
ton, offer a dispatching service cyclists can call in an
ncy for free rides home. And some employees are
nough to have a boss like WRQ's Walker, who bought
a small car for his company's bike commuters to use for errands or appointments.

For those of us who hop on our bikes each day, the rewards far outweigh the hassles. And we feel like we're doing a little something for the planet. ■

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PRODUCT WATCH

Fancy Eats: Hot, Sweet, and Savory

There's no better place to chart the gourmeting of America than at the **Fancy Food Show** in New York. The summer event, which ran from June 29 to July 1, offered samplings of 60,000 items to retailers looking to stock their shelves with exotic sauces, ready-to-eat entrées, and restaurant-style desserts. Here are my favorites:

FOR SALAD, ADD VINEGAR

Chipotle, made of dried, smoked jalapeno peppers, appears in everything from meat glazes to double-fudge chunk cookies. Check out **Bronco Bob's Chipotle Sauces** from Lady Walton's Cookies of Dallas (ladywalton.com) in Roasted Raspberry, Tangy Apricot, Wild Cherry Berry, and Smoked Bacon ($7 to $8 per bottle). They're great not just for grilling but as a salad dressing (mixed with vinegar).

READY FOR THE MICROWAVE

Kettle Cuisine of Chelsea, Mass. (freshsoup.com) uses a rapid-chilling method to create fresh-tasting, all-natural soups sold refrigerated in 10-oz. microwaveable bowls ($2.49 to $3.49). It ransacks the globe for recipes, from Southwestern-style Grilled Chicken and Corn Chowder to Thai Shrimp, Scallop, and Zucchini Soup.

Dessert? Try a **Chocolate Truffle Marquise** ($2.99 to $3.99) from Galaxy Desserts in San Rafael, Calif. (galaxydesserts.com). The mousse cake, glazed with bittersweet chocolate, layers chocolate ganache on a chocolate sponge cake, topped with a chocolate bar and a hazelnut.

MOUSSE CAKE

Gerry Khermouch

A Tax Deal Too Good To Be True?

Rules for family partnerships may get stricter. BY ANNE TERGESEN

FOR YEARS, the Internal Revenue Service has brought lawsuits to invalidate the generous tax breaks claimed by family limited partnerships—popular vehicles often used to pass wealth to younger generations. And for years, the IRS has had little success. But in May, the tax man's luck changed.

That's when a U.S. tax court rocked the quiet world of estate planners by declaring tax breaks off-limits to a Texas partnership. The court did so on the grounds that its donor, Albert Strangi, had retained too much control over key decisions, such as the distribution of money among partners. "For a lot of people who set these up, maintaining control is very important," says Joanne Johnson, managing director at JPMorgan Private Bank in New York. "But now, they may have to compromise on that control."

Typically with these arrangements, the donor, say, a father, gives at least $1 million of assets, such as stocks, real estate, or stakes in a family business, to a partnership. Generally, he allocates 99% of the shares to his kids, while keeping 1% for himself. Despite his small ownership stake, until now the father has been able to retain decision-making authority by naming himself or an entity he controls general partner. The children, in contrast, are usually designated limited partners with no voice.

The benefit of all this is that instead of paying gift taxes on the full value of the shares he gives his kids, the father pays tax on a far smaller amount. Why? Because the kids' shares are often discounted by 20% to 40%, in part to reflect that they can't be sold as easily as, say, stock in General Motors or IBM, says Dane Dudley, partner at Day, Berry & Howard in Hartford, Conn.

INVALIDATING THE DISCOUNT

The Strangi case created an uproar in part because the court invalidated the discount. As a result, the court found the Strangis liable for taxes on the full $11 million value of their partnership's assets, instead of on the nearly $6.6 million they had claimed. The court reasoned that because Albert Strangi, who died in 1994, retained control in conjunction with family members over the partnership's decisions, he hadn't really given anything away. So everything was brought back into his estate.

The ruling may be reversed or toned dow

Strangis' Norm Lofgren, a partner at Reed & McGraw in Dallas, s family is weighing an appeal. N tate planners are advising donor duce—or even relinquish—cont partnerships they've funded. "T the death knell of family limite nerships," says Don Weigandt, m director at JPMorgan Private Los Angeles. "But it's going t planning them more difficult."

If you have a family partner are considering establishing o can lessen the risk of an IRS ch Make sure you're running the p ship according to strict rules desi prevent conflicts of interest. That maintaining a separate bank acc the partnership, paying each pa proportion to his owners declaring distributions w underlying assets perform not, for example, wh donor needs to pay a bil

It's also important to ine how much control th has over a partnership. If a pa the sole general partner, it may dent to turn over control to a pendent third party, such as a b countant, or lawyer, says J Although giving up control isn't desirable, it's better than payin tax than you have to.

In May, a tax court declared tax breaks off-limits to a Texas family limited partnership on the grounds that its donor had retained too much control over key decisions

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A LEGAL WAY TO KEEP INVESTOR IN THE DARK

BY ROBERT BARKER rb@businessweek

JUST WHEN YOU THOUGHT transparency in corporate financial reporting was improving, along comes this: More public companies are telling the Securities & Exchange Commission they will deregister, meaning they will stop submitting quarterly financial reports and other key disclosures.

Rules set by the SEC in 1965 let U.S. companies "go dark," as the move sometimes is called, when their shareholders of record fall below 300 (or 500, if assets total less than $10 million). Now, a group of nine institutional investors is complaining that increasing numbers of much bigger companies are thwarting the aim of the rules. On July 3, they petitioned the SEC to close what they call a loophole in its deregistration policy. It allows U.S. companies to count holders of record, which is usually far lower than actual shareholders since many investors have a broker keep stock for them. "These companies that had taken full advantage of the equity markets all of a sudden say: 'We're going to turn the lights out,'" Carr Securities President Walter Carucci told me.

A prime example is SmartDisk, a Fort Myers (Fla.) data-storage company that went public in 1999 at $13 a share. Soon, its stock soared to $67.50 before plunging in the tech rout. On Mar. 31, SmartDisk's last 10-K filing reported assets of $17 million and more than 6,000 stockholders. But on May 7, SmartDisk told the SEC it would deregister because it has only 278 holders of record. By deregistering, it could no longer trade on NASDAQ, and the stock that day fell to 6¢ a share from 35¢. Lately, it traded over the counter at 10¢.

No one alleges that SmartDisk did anything illegal. "What we did was very legal, and beyond that, I feel it was ethically very sound," SmartDisk CEO Michael Battaglia told me. He said investors will benefit because SmartDisk will conserve assets as it escapes the costs of complying with regulations, particularly those imposed by last year's Sarbanes-Oxley Act. He added: "We never looked upon that rule as a loophole."

Owners of SmartDisk stock might weigh the trade-offs differently. Beyond suffering less liquidity in selling shares of a closely held company, investors may have a harder time keeping tabs on the business. For example, with registered stock, SmartDisk had to report in its Apr. 25 proxy statement all about a $305,114 loan it made to Battaglia in 1998. Last year, directors extended the loan's due date to 2005, lowered its rate, and eased other terms. At yearend, Battaglia s SmartDisk $277,000. Now, investors are not assured ing such details.

How many SmartDisks are there? The SEC doesn companies going dark, never mind the smaller nu those with thousands of shareholders. A search archives for filings on Form 15, which is how co deregister, found just 71 in 1994. By 2002, there w The average over those nine years was 675. Th through July 15, there were 509 filings, up from 45 comparable 2002 period (chart). These totals, it's im to note, also include filings to deregister shares bou in mergers, plus bonds and ot deemable securities.

If the data are imprecise, th seems clear. Besides SmartD institutional investors' petit 23 more recent Form 15 deems questionable, inclu bany (N.Y.) trucker Unite Services, with an estimat holders. CEO Michael Wysc United Road was qualifie Form 15, and its 294 ho record is accurate.

The question for the s rules set 38 years ago stil today's markets. Egon G an American University l fessor and expert in th thinks not. Bigger compani dark this way, he said, the law's spirit. How m vestors are too few for to protect? That's beyond any outfit with thous shareholders strikes me definition of a public com

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THE PENTAGON MAY WARM TO HOLLIS-EDEN PHARMACEUTICA

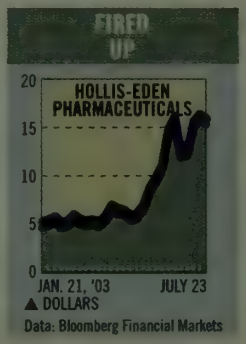
GENERIC DRUGMAKER IVAX COULD BE SET TO GO ON THE BLOC

ZIONS BANCORP'S ROBUST EARNINGS MAY ATTRACT SUITORS

BY GENE G. MARCIAL

A Radiation Antidote?

Tiny Hollis-Eden Pharmaceuticals (HEPH) is red-hot: Its shares zoomed from 3.39 last October to 16.97 on July 9, before easing to 16.09 on July 23. What's firing things up? Some pros are turned on by prospects of its "immune-regulating hormones" in treating immune-system disorders—including radiation woes. Hollis-Eden has teamed up with the Armed Forces Radiobiology Research Institute to develop HE2100, which shields military personnel against nuclear radiation. Given before—or up to two hours after—exposure, HE2100 shows "surprising efficacy" in protecting the immune system, says Jon Hickman of Halpern Capital, by stimulating rapid production of infection-fighting cells called neutrophils. Hickman, who owns shares, expects Food & Drug Administration approval of HE2100 by the third quarter of 2004. Hollis-Eden will benefit, he notes, from a new FDA policy allowing a quick O.K. for drugs that help the Defense Dept. and Homeland Security in biological or nuclear attacks. Hollis-Eden is conducting human safety trials, plus tests on monkeys, which are expected to finish next year. Hickman calls the stock "extremely attractive" based on its modest market cap of $196 million and a price only nine times his 2004 earnings estimate of $1.60 a share on sales (mostly HE2100) of $100 million.



Anne Anderson, president of Atlantis Investment, which owns shares, says initial results of animal efficacy studies are favorable. She figures that if Defense finds HE2100 effective, Hollis-Eden may get an order in the range of $160 million. That, says Anderson, should hike the company's market value to $500 million, or 29 a share, by yearend 2004.

Ivax May Be Buyout Bait at Last

Ivax (IVX), big in generic drugs, is no stranger to takeover buzz. But after years of fruitless waiting, most investors have given up the notion that Chairman and CEO Phil Frost, who owns 16% of the stock, will pull a deal. But that idea has sprouted up again. "Our sense is that Frost, now 66 years old, is ready to sell," says one hedge-fund manager, a major Ivax holder. With the stock at 17—down from its 2001 high of 41—it's takeover time again, he thinks. Joseph Zock, president of Capital Management ates, who has owned shares since 2001, agrees. Zoc bases his investment decisions on his close reading of the CEO. At a recent stockholders meeting, Frost seemed "distant," says Zock, and seemed less involved in Ivax' daily operations, very unlike the hands-on boss he used to be. After nearly 20 years at the helm, Frost could be ready to cash in, says Zock, who is in Ivax for its "robust drug pipeline" in branded and generic lines.

Harvey Eisen, chairman of Bedford Oaks Partners, also likes Ivax as a generic and takeover play. "I'm convinced that at one pc will sell," he says. Based on his projected earnings share in 2003, 90¢ in 2004, and $1.10 in 2005, he expe stock to leap to the low 20s in 2003. In a deal, Iva fetch up to 30, he says. Frost won't comment on rum says he'll do what's best for shareholders.

Tall in the Saddle At Zions

A regional bank out West, Zions Bancorp (ZI left most rivals in the dust. The stock, tra 34 in October, 2002, took a leap, soaring to July 23. Part of the reason is solid e growth. Another: buyout chatter. After Zio ed second-quarter earnings of $1.02 a share—beating co estimates of 98¢—John Kline of Sandler O'Neil & Partners upped his 2003 estimate from $4 a share to $4.10 and his 2004 estimate from $4.40 to $4.45, vs. $3.67 in 2002. Also, Kline boosted his rating from "hold" to "buy" and his 12-month price target from 53 to 60—or 13 times his 2004 estimate, in line with its peers. Buyout talk also buoyed the stock: "Some foreign banks are eyeballing Zions," says a hedge-fund manager who asked not to be identified. They want to expand into the U.S. through acquisitions. This pro Bank of America wanted to buy Zions two years a talks fell apart. A Zions spokesman declined comment.

BusinessWeek online Read Gene Marcial's Inside Wall Street Onli monthly column at www.businessweek.co today.htm. And see him Fridays at 1:20 p.m. EST on CNNfn's *The Money Gan*

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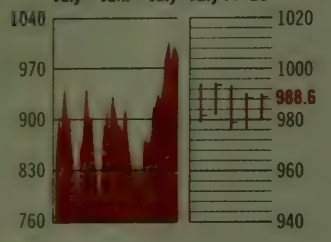
BusinessWeek Investor FIGURES OF THE WEEK

STOCKS



COMMENTARY

Stocks ended the week mixed, with the Dow Jones industrials adding 1.1% and the S&P 500 and NASDAQ losing 0.5% and 1.6%, respectively. Better-than-expected earnings from such companies as Eastman Kodak and Amazon.com had a muted effect as investors were distracted by the bond market, where prices fell and the 10-year note ended at 4.11%.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	JULY 23	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	988.6	–0.5	12.4	23.9
Dow Jones Industrials	9194.2	1.1	10.2	19.4
NASDAQ Composite	1719.2	–1.6	28.7	39.9
S&P MidCap 400	492.5	–0.8	14.6	24.6
S&P SmallCap 600	228.3	–1.2	16.1	25.7
Wilshire 5000	9515.5	–0.7	14.1	25.2
SECTORS				
BusinessWeek 50*	583.2	–0.7	7.5	21.9
BW Info Tech 100**	310.0	–3.2	8.6	18.5
S&P/BARRA Growth	502.1	–1.0	11.9	22.4
S&P/BARRA Value	483.1	–0.1	12.9	25.5
S&P Energy	191.1	1.5	4.3	16.6
S&P Financials	343.5	–0.8	15.7	30.3
S&P REIT	102.2	–1.1	12.5	19.2
S&P Transportation	178.2	–0.4	4.9	10.9
S&P Utilities	105.9	0.7	8.3	23.5
GSTI Internet	133.6	2.2	78.8	119.1
PSE Technology	587.4	–1.3	28.2	38.6

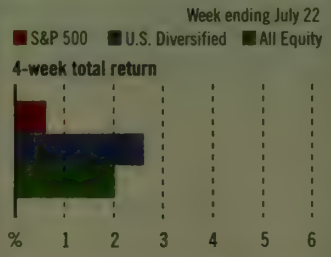
*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

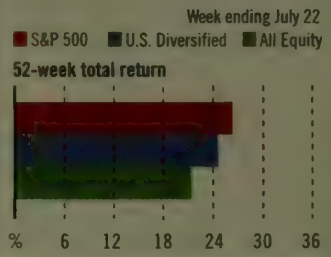
GLOBAL MARKETS	JULY 23	WEEK	YE
S&P Euro Plus (U.S. Dollar)	949.6	0.5	
London (FT-SE 100)	4086.5	0.2	
Paris (CAC 40)	3089.4	–1.9	
Frankfurt (DAX)	3304.5	–2.5	
Tokyo (NIKKEI 225)	9615.3	–1.2	
Hong Kong (Hang Seng)	9900.6	–3.0	
Toronto (S&P/TSX Composite)	7231.3	2.1	
Mexico City (IPC)	7280.7	3.7	
FUNDAMENTALS	JULY 22	WK. AG	
S&P 500 Dividend Yield	1.65%	1.6	
S&P 500 P/E Ratio (Trailing 12 mos.)	31.1	32	
S&P 500 P/E Ratio (Next 12 mos.)*	17.0	17.	
First Call Earnings Surprise*	6.01%	4.2	
TECHNICAL INDICATORS	JULY 22	WK. AG	
S&P 500 200-day average	903.7	899.7	
Stocks above 200-day average	80.0%	85.0	
Options: Put/call ratio	0.71	0.68	
Insiders: Vickers NYSE Sell/buy ratio	4.12	4.08	

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Semiconductor Equip.	16.9	Internet Software	153.5
Electric Mfg. Svcs.	15.3	Internet Retail	114.9
Semiconductors	15.3	Office Electronics	95.3
Employment Services	14.3	Biotechnology	91.5
Internet Retail	11.7	Wireless Services	82.5

WORST-PERFORMING GROUPS	LAST MONTH %	
Tires & Rubber	–11.4	Tires & Rubber
Oil & Gas Drilling	–9.0	Health-Care Facilities
Intgrd. Telecomms. Svcs.	–8.8	Food Chains
Multi-Utilities	–8.6	Automobiles
Tobacco	–8.0	Tobacco

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Pacific/Asia ex-Japan	7.6	Communications	39.7
Technology	6.5	Health	35.3
Japan	6.0	Technology	32.2
Small-cap Growth	5.8	Small-cap Growth	29.9
LAGGARDS		LAGGARDS	
Utilities	–4.2	Japan	–9.2
Natural Resources	–2.8	Diversified Pacific/Asia	–2.7
Europe	–0.5	Pacific/Asia ex-Japan	3.4
Domestic Hybrid	–0.2	Foreign	7.0

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
American Heritage	28.6	Jacob Internet	133.3
PFds. Smicdr. Usctr. Inv.	22.2	Fidelity Adv. Lvgd. Co. A	114.2
Apex Mid Cap Growth	16.1	Apex Mid Cap Growth	107.5
Firsthand Tech. Value	15.0	PFds. Biotch. Usctr. Inv.	105.7
LAGGARDS		LAGGARDS	
PFds. UltSh. OTC Inv.	–11.6	Rydex Dynam. Vent. 100	–66.1
Rydex Dynam. Vent. 100	–11.4	PFds. UltSh. OTC Inv.	–66.0
Sm. Barney Telcmms. Inc.	–8.8	Rydex Dyn. Tempest 500	–47.5
Rainbow	–7.4	ProFunds UltBear. Inv.	–47.4

INTEREST RATES

KEY RATES	JULY 23	WEEK AGO
MONEY MARKET FUNDS	0.65%	0.67%
90-DAY TREASURY BILLS	0.91	0.89
2-YEAR TREASURY NOTES	1.49	1.43
10-YEAR TREASURY NOTES	4.11	3.92
30-YEAR TREASURY BONDS	5.04	4.90
30-YEAR FIXED MORTGAGE †	6.05	5.96

†Bankr

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND
GENERAL OBLIGATIONS	3.79%
TAXABLE EQUIVALENT	5.41
INSURED REVENUE BONDS	3.79
TAXABLE EQUIVALENT	5.41

THE WEEK AHEAD

CONSUMER CONFIDENCE *Tuesday, July 29, 10 a.m. EDT* ▶ The Conference Board's July confidence index probably improved to 84, from 83.5 in June. That's based on the median forecast of economists surveyed by MMS International.

BEIGE BOOK *Wednesday, July 30, 2 p.m. EDT* ▶ The Federal Reserve will publish its roundup of regional economic activity ahead of its policy meeting on Aug. 12.

GROSS DOMESTIC PRODUCT *Thursday, July 31, 8:30 a.m. EDT* ▶ The economy is forecast to have grown at an annual rate of 1.8% in the second quarter, little better than the 1.4% pace of the first quarter.

EMPLOYMENT *Friday, Aug. 1, 8:30 a.m. EDT* ▶ Nonfarm payrolls in July probably slipped by 5,000, while manufacturers most likely cut 35,000 jobs. The unemployment rate is expected to have held at 6.4%, while the average workweek very likely inched up to 33.8 hours.

PURCHASING MANAGERS' INDEX *Friday, Aug. 1, 10 a.m. EDT* ▶ The Institute for Supply Management's industrial activity index for July probably rose to 51.3%, from 49.8% in June. It would be the first readin 50%, the point between rising and ing factory activity, since February.

The *BusinessWeek* production index 200.8 in the week ended July 12, up 0.6 a year ago. Before calculation of the fo moving average, the index climbed to 1

BusinessWeek online

For the BW50, more investment data, ar components of the production index v **www.businessweek.com/magazine/ex**

ex to Companies

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on a company. Most subsidiaries are indexed under their own names.
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This is part of the Heidrick & Struggles' SAGE series (Strategic Advice on Governance and Executives).

How To Select An Executive Search Firm

By

Heidrick & Struggles

Imagine a stone dropped into a pond, whose ripples disperse erratically, growing and gathering strength until they reach the water's edge with tsunami-like proportions. The final effect can be carefully planned, but never entirely predicted. This image illustrates what can follow the hiring of a new senior-level executive. Once made, this single choice sets in motion a series of related events, decisions and directives, actions and reactions that reverberate and build upon one another indefinitely.

Therefore, the responsibility of selecting an individual with talent and experience perfectly suited to a company's long-term needs cannot be underestimated; neither can the consequences of a misstep.

It is little wonder, then, that so many organizations are enlisting specialists in the field of executive recruitment when seeking talented individuals for their highest levels. It is our professional belief that the selection of an executive search firm can and should be approached with the same discernment and rigor as that applied to selecting the candidate who will ultimately fill the role.

While many organizations feel confident in a top-tier search firm's ability to judge the credentials and capabilities of candidates, fewer may be as certain about the best method for evaluating the suitability of an executive search firm. As experts in corporate governance and leadership, Heidrick & Struggles has a unique perspective on both sides of this equation. Through our 50 years of experience, we have amassed a collection of recommendations to offer organizations facing the challenging task of selecting the right search firm.

Why Use A Search Firm?

Leadership succession is among the prima facie duties for every board of directors, and the hiring of key general management executives should also be a fundamental priority for CEOs and other senior management. But shouldn't they be capable of doing this unassisted? The answer is yes, and some do. But they often find themselves unacquainted with the market of available candidates, and bound by the limitations of their own professional networks, the necessity of confidentiality, and the differences of opinion that can cloud even the clearest of intentions.

In contrast, an executive search firm can objectively assess spoken and unspoken requirements, and then approach with absolute discretion the highest quality candidates regard[less] their employment status. Also, some search firms have dev[eloped] specialties in leadership assessment and executive coa[ching], giving them insight into the qualities and competencie[s] typically translate into success in critical senior-level posit[ions].

Selecting A Search Firm

One of the most important aspects of selecting the right s[earch] firm for your organization is understanding the value a s[earch] firm provides. Search is a consultative and collaborative pr[ocess] whereby a search firm assumes the overall obligation to ide[ntify], attract, and present qualified candidates deemed suitable [to] client. To best serve the long-term objectives of a company, [its] and their hiring managers would be wise to evaluate each pot[ential] search firm according to these critical guidelines:

- Which firm and consultant team, by reputation, skill[s] prior experience will be able to first *identify*, and more im[por]tantly, *gain access* to the most qualified executives fo[r] position? Of all the value an executive search firm pro[vides] the access and influence a search firm possesses may ha[ve] most significant impact to the outcome of the search.

- Which search firm can provide consultants who truly po[ssess] a thorough understanding of all the strategic, financia[l] operational issues your company is facing? Unsurpris[ingly] world-class search firms can attract and recruit world-[class] consultants. With a solid understanding of the key issue[s], ample relevant experience, the right consultant team can [get] a quick start on conducting the search as well as detec[t] ward off any potential problems along the way.

- Does the search firm fully understand the unique cultu[re] your organization, its strengths and challenges, and gre[at] needs? Our experience over the past five decades has ta[ught] us that companies are unique, each having a distinct cu[lture] and set of values. It is no simple undertaking to prese[rve] culture while at the same time energizing it with new p[eople] who bring with them fresh ways of thinking.

- Which firm understands the core competencies require[d] the placed executive to succeed? Whether your organiz[ation] faces a turnaround scenario, a succession planning issu[e] simply hopes to stay on a successful course, the firm

t should be well-versed in sourcing e candidates with the precise skill nd experience required.

e suitable candidates are identified contacted, which firm will be the "ambassador" to present the rtunity and create interest, and nately "close the deal" with the best lidate?

t priority will be given to your ch by those involved? As mentioned er, this decision represents a seri- and far-reaching responsibility that rves top priority not only from organization, but from the firm retain.

comfortable are you with the con- nts who will be responsible for aging the relationship with your bany? How confident are you in their osed approach? Your impression of is likely to resemble the impres- your potential candidates gather as The highest standards of profession- n, expertise and trustworthiness ld not just be talked about by the they should be evident.

things to consider include the geo- cal extent of the search. Will the be national or multinational, and firms under consideration possess ources and capabilities to conduct gnment of this scope? Also, consider possible industry and functional where qualified candidates may be Which firms have substantial and riate resources, contacts and track s in these areas? And finally, invest ne to personally check each firm's nces. More can be learned about the and consultants in this manner almost any other way.

art of the final evaluation of search the following information can be ed in a proposal or discussed in the in-person presentation:

t of the search firm's activities and pleted searches in relevant positions industries during the past five s;

essional references, including rele- industry and general business ers, current and former clients, placed candidates who can appropri- evaluate the capability of the ultant(s) involved;

- A demonstrated knowledge of your organization (its operations, products and services, strategies as well as outlook) and a similar understanding of relevant industries;
- A preliminary search strategy based on company and industry knowledge;
- An overview of the firm's search process and methodology;
- The firm's fee schedules, including an outline of any expenses beyond the fee.

WHY HEIDRICK & STRUGGLES?

As the leader in executive search, we are highly committed to serving our client's interests. Our top priority is forging long-term relationships with clients and candidates, and for five decades we have helped businesses in every industry build thriving, high-performance management teams. We are an international search firm with a reputation for successful and impactful search completions for senior-level positions. Our access to the market's best talent and our ability to recruit these executives is unparalleled. Our consultants are the best in the industry.

Heidrick & Struggles has long been a proponent of the value of people. People who can add significantly to the value of an organization. People who can capture the imagination of the marketplace, unleash ideas and energy in the people around them, and win the trust and confidence of investors and the organization. It is people, after all, who shape and grow strategy, capital, products and brand, and all the disparate elements that constitute the entity we think of each time the word "company" is used.

Invest time and care in selecting the firm that will assist you in selecting talented individuals. It is one of the wisest investments any company can make.

REASONS TO USE EXECUTIVE SEARCH

- A qualified, experienced and objective third party identifies and evaluates the appropriate talent for your organization.
- Often the need for confidentiality is high enough that companies are limited in their ability to source or approach candidates on their own. A search firm can maintain discretion within the client organization and to the outside market.
- Searches are often conducted at times of duress or change, so drawing upon a search firm's demonstrated capability and experience of placing top-tier executives in relevant industries can significantly reduce a company's risk when embarking on a critical search.
- Search firms will typically ask and help companies work through the tough questions regarding the structure and reporting relationships of the open position, the priorities of the company, and the level and type of candidate the company realistically hopes to attract.
- Without a search firm present, a company may not be successful in bringing to the surface issues and disagreements as to the ideal candidate. Worse, when candidates come for an interview, they may perceive differences in these individual expectations, which may cause them to withdraw as a candidate.
- Search firms provide a mechanism to interview and assess internal and external candidates in-depth, simultaneously. Search firms can also help to absorb internal and external sensitivities and "political" pressures.
- Search firms handle all interviewing and scheduling logistics, and manage client and candidate concerns throughout the process.
- Search firms conduct professional referencing. Often these references are more candid with search firms, providing a complete and balanced description of the candidate.
- Search firms assist in negotiating the offer and reaching closure with the final candidate of choice.
- A professionally directed search provides a much better chance of success for finding and recruiting the best long-term "fit" for an organization.

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WHAT THE BOND MARKET IS TELLING US

This recession and recovery aren't following the path economists had come to expect. In the past, the stock market has almost always anticipated the end of a recession by moving upward before the economy began its ascent. This time, though, the market didn't bottom out until October, 2002, even though the National Bureau of Economic Research recently declared that the official end of the recession came in November, 2001.

The bond market, too, is behaving in peculiar ways. Following the recessions of 1981-82 and 1990-91, long-term interest rates didn't begin to rise until the job market started to recover in earnest. Not so this time. Since July 3, when the June employment report from the Bureau of Labor Statistics confirmed that the economy is still shedding jobs, interest rates on 10-year Treasury bonds have risen sharply, to over 4% (page 28). That's still low in historical terms, but it may be enough of an increase to make homeowners less enthusiastic about refinancing.

The combination of rising rates and a weak labor market poses tricky problems for investors and Washington policymakers alike. For investors, the issue is whether they should bet on continued job losses and a sluggish economy, or whether there's a greater probability of faster growth, high deficits, and increased inflation. We think the latter scenario is more likely thanks to lower taxes, higher government spending, and a fast-growing money supply. how events play out, it could send long-term rates s 5% or more very quickly.

As a result, investors should be extremely wary, e those who, searching for safety, shifted into bond fu getting burned by the stock market. An increase in rates from 4% to 5% on a new 10-year bond wou roughly a 7%-to-8% drop in the value of the bon ment. That would take a big bite out of wealth.

Policymakers at the Federal Reserve, too, need their way across the economic landscape carefull have kept monetary policy very loose and short-t terest rates low to manage the post-boom slugg But it's also worth remembering that higher long-t terest rates generally signal a return to faster gro higher inflation in the near future. That means, publicly worrying about deflation, the central ba need to refrain from loosening monetary policy a ther to avoid letting inflation get a toehold.

In the early 1990s, Democratic political strategis Carville said that he wanted to be reincarnated as t market, because it "can intimidate everybody." Even its movements are more difficult to decipher now th were before, when the bond market speaks, it's still listen.

VERIZON'S DARING VISION

Economists keep scanning the horizon for signs that business capital spending is about to revive. The latest report from the government, released on July 2, showed that orders for nondefense capital goods are still flat, with few indications of an impending revival.

In the midst of this stagnation, one encouraging piece of news is the commitment of Verizon Communications—led by CEO Ivan G. Seidenberg—to spend $20 billion to $40 billion over the next 10 to 15 years to build fiber-optic connections to every home and business it serves. (page 52) Verizon is also deploying 3G, or third-generation, wireless technology faster than rivals and setting up Wi-Fi hotspots in Manhattan. Verizon's ambitious plans are becoming reality despite flat revenues for the phone industry and pricing pressures that make it tough to boost profits.

Seidenberg's leap into the future is one of the first real signs of life in the telecom sector, whose downturn helped usher the economy into its current doldrums. Communications equipment has accounted for roughly one-third of the decline in business equipment spending since the peak of the boom in 2000. Unless the telcos chip in and step up their capital outlays, a real recovery in business spending will be slow in coming.

Moreover, bringing fiber to the home has far-re implications for economic growth. Such fiber conn could provide more bandwidth than current cable m delivering brand-new services and entertainment digital household of the future.

So far, no other telcos have followed Verizon's ex As of July 23, Verizon is the only major phone co whose capital spending for the last quarter has inc compared with the year-earlier period. Capital expen at rival SBC Communications Inc., the second-largest company, are down almost 50% over the past year. ing is also down at AT&T, BellSouth, Sprint, and Communications.

Could such prudence, bad for the economy, be the course for individual phone companies? There's no that Verizon's expansion plans are risky. Phone com have announced fiber-to-the-home initiatives before, retreat in ignominy when the costs turned out to high, the technologies too tricky, and the payoff too too distant.

This time, though, Seidenberg seems serious and mitted. We regularly chide CEOs for being too cautio good to see one who isn't.

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THE CRISIS AT NASDAQ

It is fast losing business to electronic rivals and the NYSE. And regulators have stalled its ambitious reorganization. New CEO Bob Greifeld has one tough job ahead.

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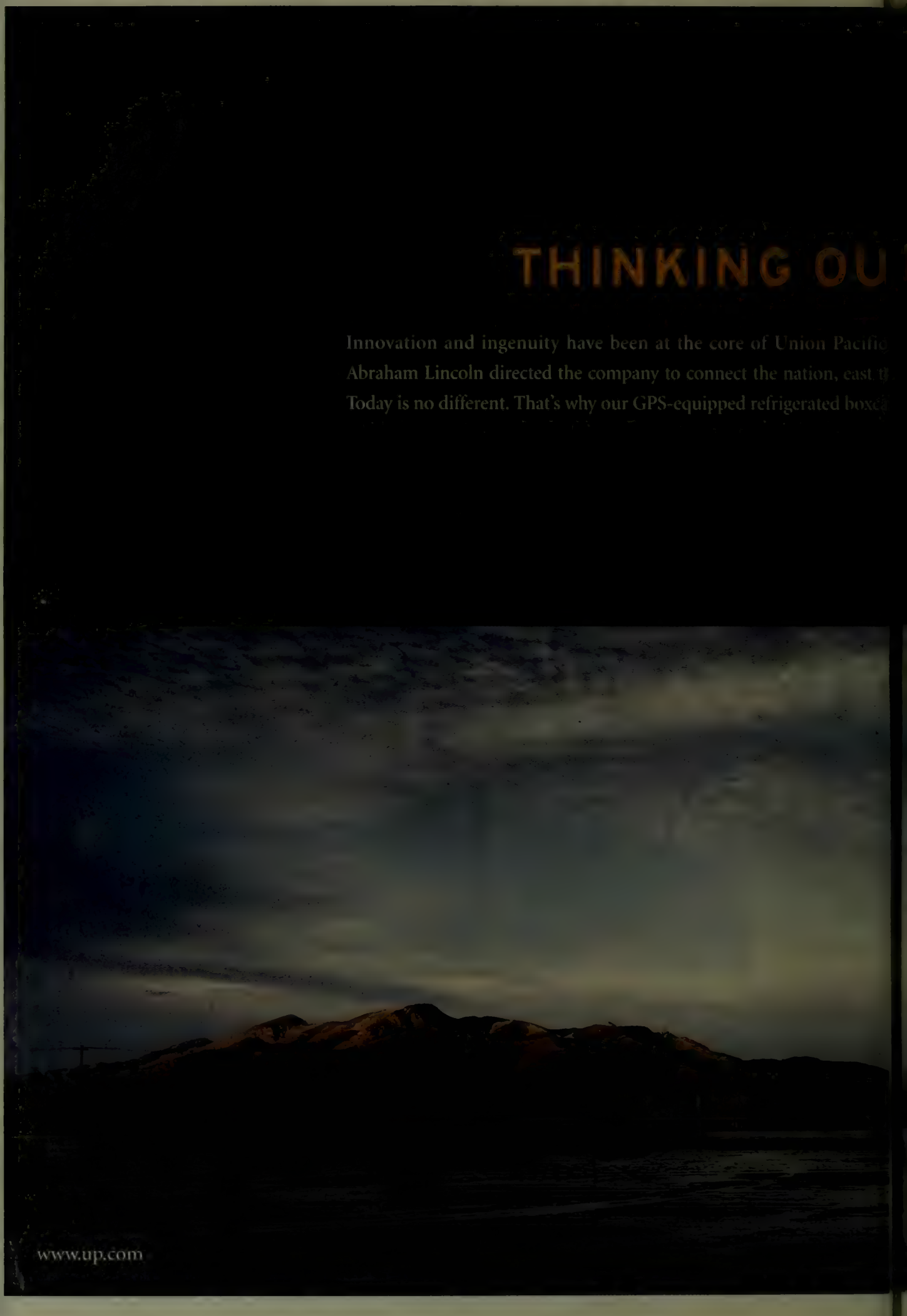
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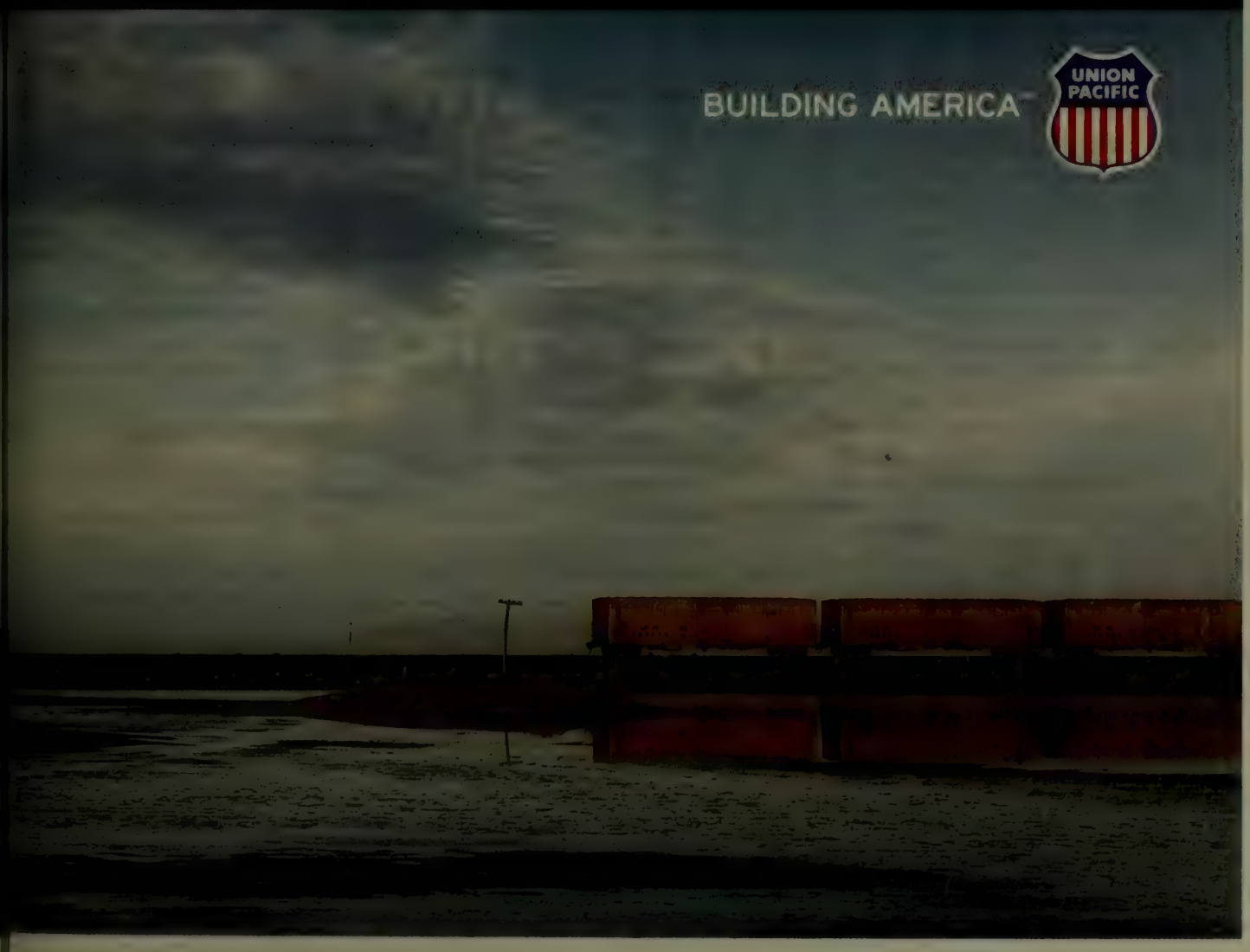

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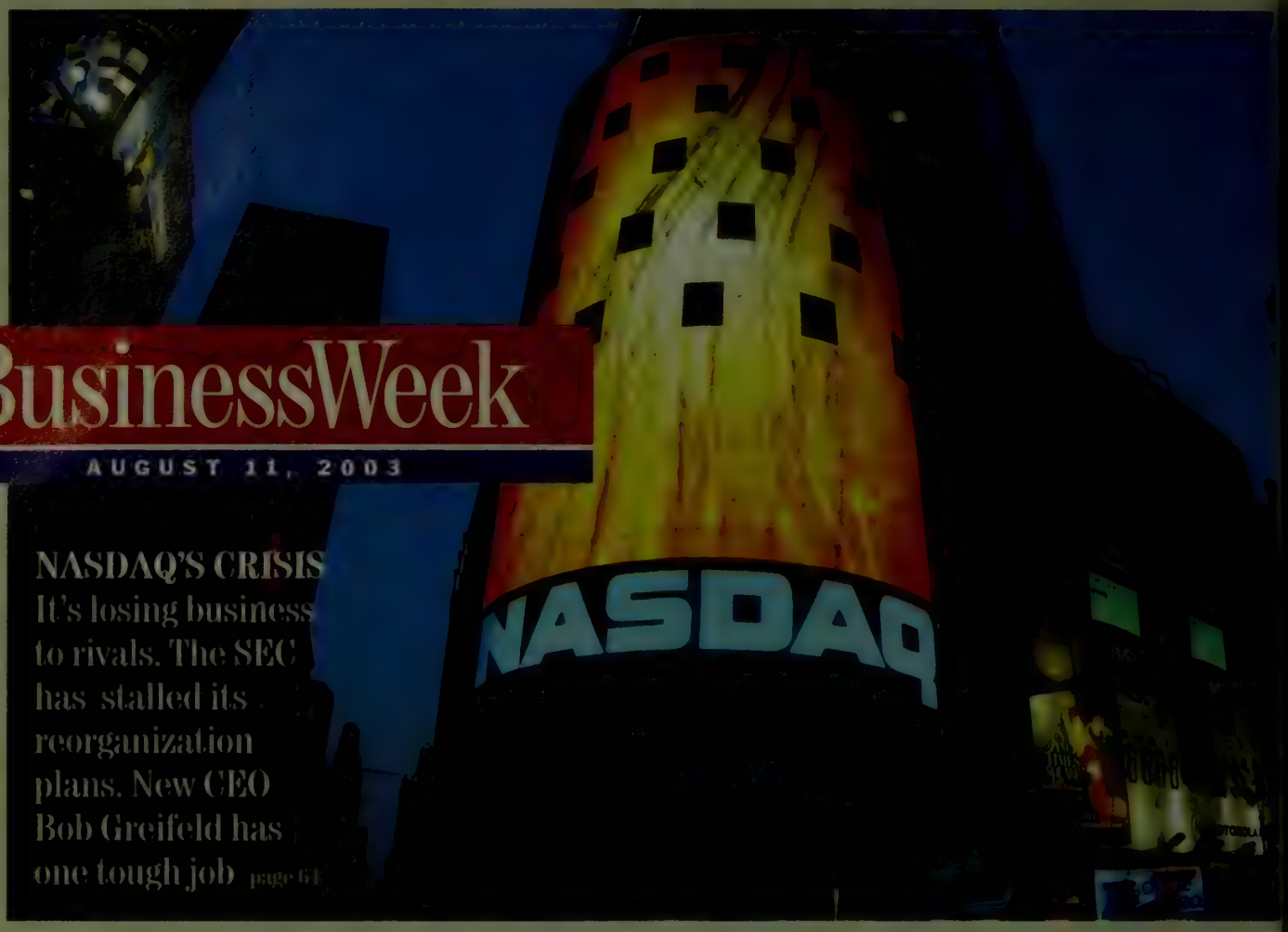

NASDAQ'S CRISIS
It's losing business to rivals. The SEC has stalled its reorganization plans. New CEO Bob Greifeld has one tough job page 64

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64 THE CRISIS AT NASDAQ
The "market for the next 100 years" is on the ropes. Three years in the grip of the bear market, its tech stars humbled, NASDAQ's revenues and profits are sliding. Superfast rivals are stealing its lunch, and defections to its archrival, the Big Board, are growing. And the SEC won't free it from its parent so it can go after the competition. NASDAQ, once the gateway to capitalism for thousands of small companies, "is on the cusp of a meltdown," says one analyst. And if that happens, it could leave a huge dent in the economy

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Up Front

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PROFIT & GLOSS

THE HOGWASH IN HEDGE FUNDS

THE $600 BILLION HEDGE-FUND industry is producing its own version of *Survivor*—only it's no hit with investors. The average fund has supposedly returned 7.9% this year, but thanks to the hedge-fund world's extreme secrecy and so-called survivor bias, the real number could be much lower. The SEC is considering new disclosure rules to address the first problem.

Survivor bias may be trickier to tackle. It's the tendency of overall performance data to include healthy funds and ignore flops. Since hedge funds aren't required to report returns, weak funds often don't. Funds that liquidate—and there have been plenty, thanks to the stock market rout—aren't usually included in industry averages. Once a fund finishes raising money, managers have little incentive to report returns to outsiders. Investors get quarterly reports, often unaudited.

The result: Hedge funds' average annual returns could be inflated by 3.7 percentage points, according to a study by the Investment Management Consultants Assn., a trade group. Richard Dahab, of investment advisers Dahab Associates, says investors should have "low expectations." The big question: How low? *Mara Der Hovanesian*

THE LIST **DOWN AND OUT IN SACRAMENTO**

The state of California finally managed to pass a budget on July 29, one month late. Why did it take so long? After generating an $8 billion surplus in 2000, California was faced with a two-year deficit of $38 billion. Some of the major contributors:

	BILLIONS
STOCK MARKET COLLAPSE DRIES UP INCOME TAX GAINS	$12.3
SALE OF TOBACCO SETTLEMENT BONDS DELAYED	6.3
ECONOMIC SLOWDOWN SAPS SALES AND CORPORATE TAXES	4.2
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Data: California Finance Dept., Milken Institute, *BusinessWeek*

CONTRIBUTED BY CHRISTOPHER PALMERI

TALK SHOW "Dozens of companies use the word 'spa their legal and commercial names and no one confuses us with the Hormel canned meat product."

—Brian Cartmell, CEO of SpamArrest, responding to Horme legal challenge against his company

RED TAPE

SORRY, YOUR JOB IS CLASSIFIED

GOVERNMENT CONTRACTORS are struggling to make the U.S. more secure. It's not the enormity of task. They simply can't get security clearances for their employees. The Pentagon concedes that it has a huge backlog of more than 240,000 applications.

Without clearances, which can take at least six months, private-sector workers can't handle classified projects. That's slowing work on many government contracts. "Cleared personnel are in short supply," says Peter LaMontagne, a senior vice-president at ManTech International, which does background checks for the Pentagon.

Herndon (Va.)-base services supplier WA Government Services, ample, wants to expa workforce from 500 t to help fulfill a $7 billio tract from the Navy sign and operate a co network. But empl need security clearan get onto 100 bases a the world. Company dent Michael J. Barbe he has 117 workers w for approval. One work been hoping for a gree for 16 months. And t no end in sight, either, security requests have rising. *Paul Magn*

REGULATION NATION

THE SEC CAN TAKE IT —AND DISH IT OUT

A LITTLE-NOTICED PROVISION in the Sarbanes-Oxley Act could have some surprising consequences—good for investors and bad for trial lawyers. Under a July 28 settlement, J.P. Morgan Chase and Citigroup agreed to pay $305 million to resolve charges that they helped Enron and Dynegy defraud investors.

But all that money won't be kept by the government. Instead, the SEC is using the law to direct $236 million to Enron victims and an additional $19 million to Dynegy victims. "It's unusual because up until last year all SEC fines went into the U.S. Trea says Georgetown law p sor Donald C. Langevo

The provision is a for investors, who shou some payback much than any lawsuit cou resolved. To ensure c nies don't pay the victims twice, those ments shou credited t any future verdicts a the two b including s holder actions.

The big are the plai lawyers. are paid contingenc sis—gene 25% to 3 the final settlement o dict. Any reduction d SEC fines will only lowe total that their fee is from. To big business, justice. *Nanette B*

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Up Front

THE DEAL MILL

CROPPING THE DIVIDEND AT KODAK?

IS IT TIME FOR EASTMAN Kodak to cut its dividend? On July 23, Kodak reported that second-quarter earnings fell 61%, to $112 million, while sales of $3.4 billion were flat compared with a year ago. Worse, the company says U.S. film sales may drop 8% this year.

To offset sliding sales in its core photography biz, Kodak has been steadily building a health-and-commercial-imaging business. On July 21, it announced the purchase of PracticeWorks, a dental-imaging company. To do more deals, Kodak may cut its dividend at its September board meeting, freeing up some of the $500 million it's slated to pay shareholders this year. "It has almost become a necessity because they need the cash," says analyst Richard Stice of Standard & Poor's.

Cutting the dividend could be a catch-22. At $1.80 a share, or 21% more than estimated 2003 earnings, the dividend has been a lure for investors. Reducing it could torpedo the share price. But other choices aren't much better. The stock is too volatile to use for acquisitions, and debt is now more expensive because credit agencies downgraded Kodak, saying PracticeWorks initially will boost debt but not earnings.

It could use cash to make more deals. Kodak says it has $838 million in the bank and expects up to $500 million in free cash flow this year after capital spending and dividends. The company says it is reviewing the dividend but won't say what action, if any, it will take. *Faith Arner*

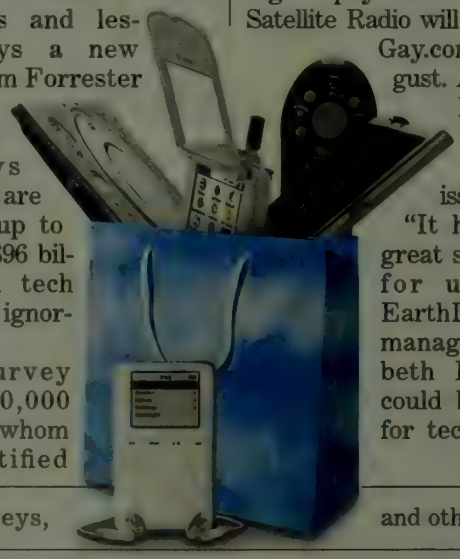
WIRED LIFE

TECH AND GAYS: A FINE ROMANCE

IT'S A TECH MARKETER'S dream: buyers who are 19% more likely to shop online and 35% more likely to have speedy Web access. Who are they? Gays and lesbians, says a new report from Forrester Research. Forrester also says marketers are forfeiting up to 5% of the $96 billion retail tech market by ignoring them.

The survey polled 60,000 adults, of whom 7% identified themselves as lesbian, gay, or bisexual. The poll found 29% of gays have been online for seven years, vs. 18% of straights. That's partly because gays used the Net early on as a link to the gay community, says Forrester.

Tech companies are starting to pay attention. Sirius Satellite Radio will run ads on Gay.com in August. And EarthLink put free CDs in recent issues of *Out*. "It has been a great strategic fit for us," says EarthLink brand manager Elizabeth Halkos. It could be a boost for techdom, too. *Kevin Joy*



DRAWN & QUARTERED

SPORTS BIZ

BEND IT LIKE— SOMEBODY ELSE

GOOD THING MANCHESTER United nearly sold out its four-match tour in the U.S. before trading superstar soccer player David Beckham to rival Real Madrid for $40 million. ManU, the world's most popular and profitable sports team, should pocket about $3 million for the matches, *BusinessWeek* has learned. But the absence of Becks, as the club's 53 million global fans call him, could dampen efforts to establish its brand in the U.S. one of the world's last untapped soccer mar

As the tour rolls to it match in Philadelphia on 3, it's clear that har U.S. soccer fans want t the club even without ham. "No one has asked refund," says ManU CE ter Kenyon.

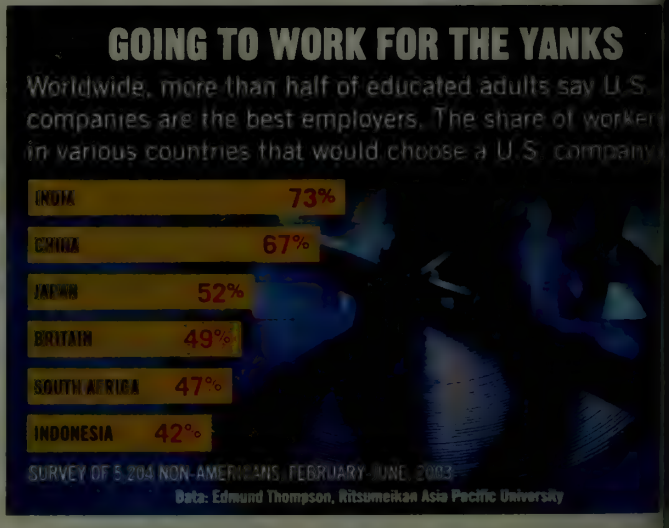
BECKHAM: *Adios*

ManU, ho er, needs to casual fans t ularize the "Becks's ab will hurt the with North A ican TV vie and in mer dise sales," Jeffrey Bliss, ident of s marketer Ja Group. In th of global ma ing, even European s clubs need a pretty fa hawk their goods. Jus Real Madrid. *Stanley H*

THE BIG PICTURE

GOING TO WORK FOR THE YANKS

Worldwide, more than half of educated adults say U.S. companies are the best employers. The share of workers in various countries that would choose a U.S. company



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Readers Report

HOW DOES STEVE COHEN DO IT?

Your article about "Stevie" Cohen was infuriating ("The most powerful trader on Wall Street," Cover Story, July 21). Clearly, the markets are stacked in favor of people like SAC Capital Advisors founder Steven A. Cohen, who (according to your writers) trades on special, nonpublic, material information that is unavailable to the public.

Geoffrey Batrouney
New Rochelle, N.Y.

You note that SAC Capital Advisors pays full commissions and thereby receives analysts' recommendations ahead of the general public. How is this different from one of his traders acting on information from his analyst wife before it is made public?

Ted Levin
Grant, Koehler & Levin Ltd.
Seattle

Editor's note: The writer is a partner in an investment advisory firm.

"The most powerful trader on Wall Street" did not make it clear just how effective the alleged "three aggressive tactics" have been for SAC Capital Advisors, and you neglected to mention the extent to which SAC uses the legal practice of "front-calling" (not to be confused with the illegal practice of "front-running"). I suspect that such tactics would not add more than a few basis or percentage points to long-term returns, and that most of SAC's returns been caused by other factors.

Charlie Stromey
Concord,

AFRICAN AMERICAN EQUALITY: NOT A BLACK-AND-WHITE ISSU

As a black professional male, I insulting and offensive that supp of affirmative action resort to des and dishonest gloom-and-doom about black progress ("Progress out parity," Economics, July 14 "Black progress: Two ways to lo it," Editorials, July 14).

First, the often-cited wage ga tween whites and blacks: The a fails to mention that more blacks the South, where wages and co living are lower. Nor does it me that among married couples, black more in parity with whites, in cases making more than their counterparts. Wealth and incom not easily correlated because wea more about keeping what is e through income.

If there should be any type of mative action, it should be base need, not race.

J. Perry Fe
Fairfield,

For African Americans to ac economic parity, they will have to uate from high school at the same as whites, achieve the same level ademic performance while in scho tend college, take degrees in the disciplines as whites, and gradua the same rates as white American

Until the pool of workers is eq qualified, the economic measuren only reflect the underlying caus economic disparity, and that is the ure of families, grade schools, and

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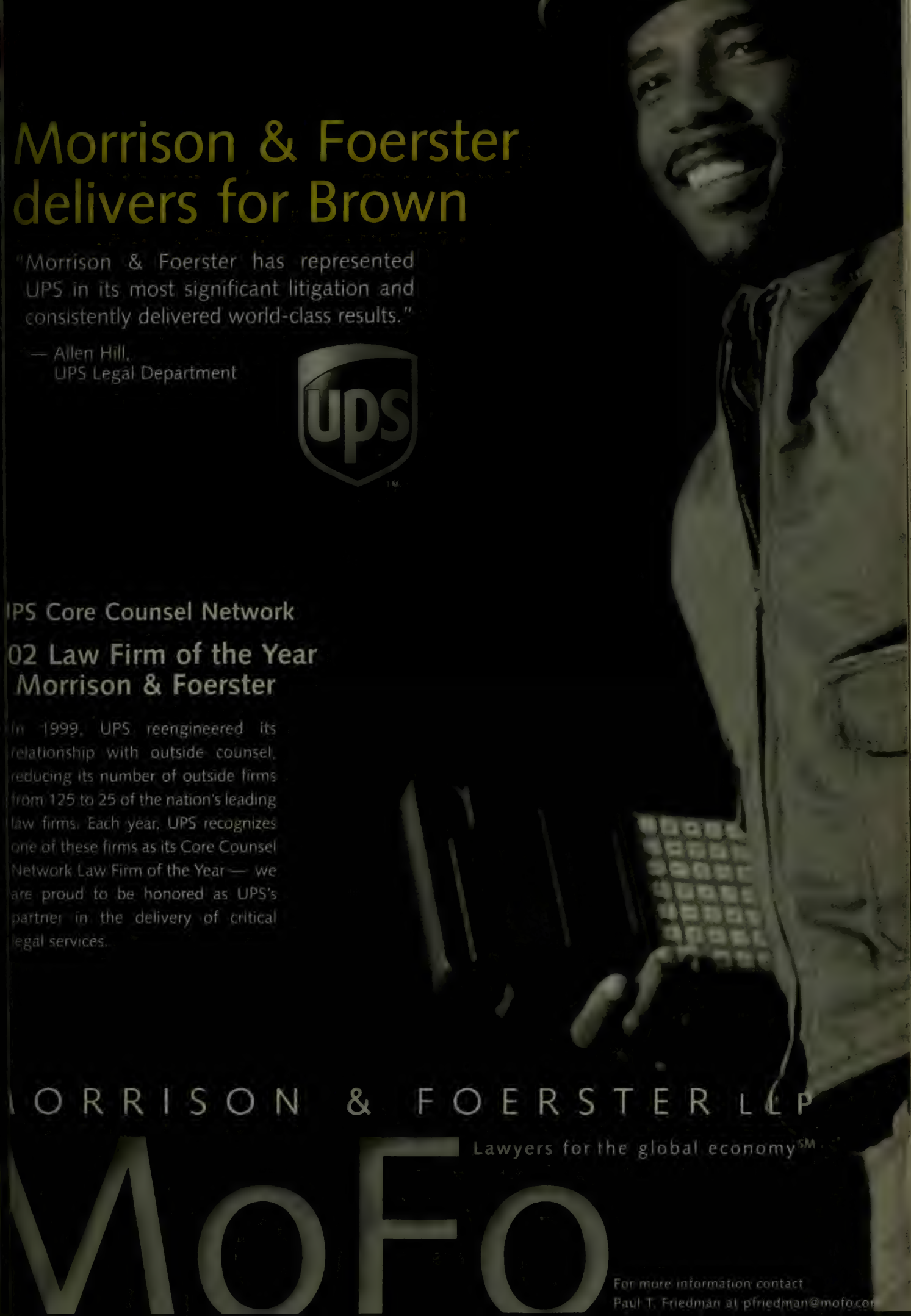

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CORRECTIONS & CLARIFICATIONS

In the table "Late to the party," which accompanied "Beyond options" (News: Analysis & Commentary, July 28), the percentage change in shares listed for ConocoPhillips, Sysco, Southwest Airlines, Safeco, and Campbell Soup was incorrectly labeled. The change represents the 2002 grant vs. the three-year average grant from 1999 to 2001, not 2002 vs. 2001. The difference at Campbell Soup Co. reflects an unusual spike in 2002 caused by a transition that the company was undergoing in 2001 and 2002, not a shift in its options plan or philosophy. For the past five years, the company has averaged approximately 6 million shares granted per year.

schools to prepare their charges for participation in the working world and society as a whole.

Joe H. Heater
Palatine, Ill.

I teach kindergarten at a predominantly African American elementary school ("How to narrow the great divide," Economics, July 14). Through a workshop, each child in my class received a newspaper each day. Even though the newspaper is considered middle-school material, I taught my 5-year-old students about the stock market, sports, how to look up the weather report, obituaries, etc. Their parents were excited about getting a free paper every day and were even more excited that their children were able to talk about the different articles.

Shann Comeaux
Scott, La.

'THE STOCK OPTION GAME IS OVER'

Option grants were a primary reason many companies went public that never should have—and most are now in the dung heap where they belong ("Will stock options lose their sex appeal?" News: Analysis & Commentary, July 21, and "Microsoft's bold new pay plan," Editorials, July 21). Has it ever occurred to people who join startups that they just may have to live off bread and water until the company shows a trend of real earnings to justify a public offering worth its salt? And venture capitalists may just have to wait it out, too. Most of them have no loyalty to the companies they fund early. They just want to game the system and bail out early.

The stock option game is over. Public investors will assure that. I would never buy into a stock if the company does not expense options. Not doing so tells me the managers don't just fudge: They cheat. And if they are duplicitous in this regard, of course they will push the envelope and try to use every accounting trick to pump up their revenues and earnings. It really makes long-term stock selection much easier.

Laurence C. Day
Agora Investment Management
St. Louis

WHERE P&G WAS FIRST —AND WHERE IT WASN'T

Procter & Gamble is a great company ("The P&G Revolution," Cover Story, July 7), but credit for the first disposable diaper goes to my father's employer, Johnson & Johnson, which began developing a product called Chux in the 1930s and introduced it in 1950. My mother told me I made many contributions to the early product tests.

Tom Coates
Baltimore

You list Pert Plus in 1986 as the first shampoo-conditioner combination. Actually, the first combination product, Wash 'n Go, was sold by Noxell (now owned by P&G) in the mid-'70s. It was not successful, but shortly thereafter Revlon introduced the very successful Milk Plus 6, also a two-in-one product.

David C. Steinberg
Plainsboro, N.J.

Editor's note: P&G acknowledges that Johnson & Johnson as well as two other manufacturers did launch disposable diapers before Pampers but that the products didn't prove long-term successes. A P&G spokesman says: "We were the first to popularize the disposable diaper, successfully bring it to market, and successfully create the category." P&G says it has no knowledge of Noxell's launching a combination shampoo called Wash 'n Go before P&G bought Noxell in 1989.

DEUTSCHE LEASING IS A SATISFIED SIEBEL CUSTOMER

I was very surprised by the statement in "Can Siebel stop its slide?" (Information Technology, June 2) that Deutsche Leasing is unhappy with its Siebel Systems Inc. salesforce-automation system. That's not true. We have over 350 users. We have realized substantial economic benefit from the use of the Siebel CRM (customer rel ship management) system. We been able to increase our sales re by 6.8% using Siebel Sales. We measured our user-acceptance with the Siebel system, and they quite good.

Unlike many CRM projects, ours been professionally managed and pleted within acceptable time budget constraints. Our project presented at the CRM-Focus Ev Montreux 2003, and was chosen the CRM-Expert-Circle in Germa the one for their 2002 Yearbook.

Friedel J
CRM-Business Di
Deutsche L
Bad Homburg, Ger

Editor's note: The story mischar ized Jonker's opinion. While he tioned a couple of problems with Systems software, overall Jonke satisfied customer.

How to reach BusinessW

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AFTER THE BALL
Gilded Age Secrets, Boardroom Betrayals, and the Party That Ignited the Great Wall Street Scandal of 1905 By Patricia Beard
HarperCollins • 402pp • $25.95

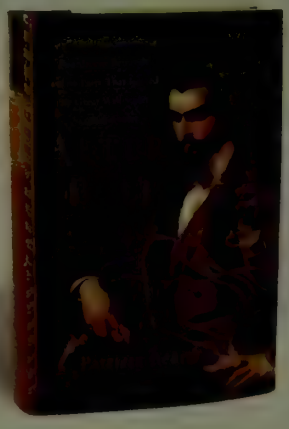
LIVING WELL WASN'T THE BEST REVENGE

Accounting irregularities, self-dealing, financial chicanery: Today's headlines repeat themes that have long bedeviled American finance, as can be seen in *After the Ball: Gilded Age Secrets, Boardroom Betrayals, and the Party That Ignited the Great Wall Street Scandal of 1905.* Author Patricia Beard, a former editor at *Mirabella* and *Town & Country*, focuses on an infamous contretemps of the early 1900s involving the Equitable Life Assurance Society, today a part of AXA Financial. Her gossipy volume is rich with Gilded Age period detail and colorful personalities. However, those seeking a sophisticated explanation of financial misdeeds may come away unsatisfied.

The story begins in 1859 with the establishment of the Equitable by the 25-year-old Henry Hyde, who used his social contacts to raise the $100,000 capital stock required of insurers by New York State law. Investors received interest and spots on the company board, while Hyde himself held on to 51% of the stock. Some 40 years after its founding, "with seventy-seven foreign offices, the Equitable was the first truly international insurance company." It boasted 300,000 policyholders and a reserve of more than $300 million—even after paying out $307 million to beneficiaries.

Upon Hyde's death in 1899, his shares in the Equitable passed into a trust established for his son, James Hazen Hyde, then 23 years old. James had shown little interest in business; his passions were horses, society, and French culture. The father specified that James would take control of the stock when the son reached 30. Until then, the company would be run by James W. Alexander, a company executive who was to mentor Hyde and eventually turn over the Equitable to him. After a trip to Paris, the young Hyde returned to the U.S., where he assumed a vice-presidency at the insurance company and life as a bon vivant and sportsman.

In that era of economic transformation and growth, insurance companies played the role of venture capitalists. Their pots of money loomed large to the era's corporate titans, who were in search of funds to bankroll acquisitions and expand existing operations. Not surprisingly, such well-known tycoons as J.P. Morgan and James J. Hill rushed to join the boards of the Equitable and other insurers. In short order, the insurers were buying the bonds of companies that these moguls controlled.



Hyde, seeing the easy opportunities, formed a syndicate, James Hazen Hyde & Associates—a vehicle through which he bought bonds as an individual, then resold them to the Equitable at a higher price. (Such self-dealing was not then illegal, the author notes.) Hyde also established an alliance with railroad tycoon E.H. Harriman, bringing him onto the Equitable board and arranging to lend him $2.7 million that Harriman wanted for his attempted takeover of the Northern Pacific Railroad.

Tensions mounted between Alexander and Hyde. The staid executive felt his young charge's ostentatious style of living, including attending glamorous balls and staging expensive coach races, could besmirch the company's reputation. Meanwhile, Hyde was coming ever closer to age 30 and the inheritance that would lead to Alexander's displacement as head of the company.

By the early 1900s, friction on the board was high—and James's opponents were looking for an excuse to bring him down. James obliged them. In 1905, he hosted a soirée at Manhattan's Sherry's Hotel—a Louis XVI costume ball attended by 600 members of the [illegible] of society. Two orchestras played [illegible] guests feasted on lobster and vi[illegible] champagne. Such occasions, Bea[illegible] serts, could make or break a part[illegible] er's reputation in society. Thi[illegible] proved James's undoing in busine[illegible] rumors spread that the Equitabl[illegible] paid for the costly affair.

The rumors, which seem to have[illegible] unfounded, became part of Alexa[illegible] attack on Hyde. He called for the [illegible] al-stock insurer to be turned into [illegible] mutual insurer—a company own[illegible] and operated solely for the benefit [illegible] policyholders. Such a change would [illegible] the end of Hyde's clout. The boar[illegible] brawl became increasingly public[illegible] ing it front-page coverage, *The New[illegible] American*, for example, observed[illegible] the fight pitted Morgan interests vs[illegible] riman and was really a "struggle fo[illegible] trol of the money lending power [illegible] Equitable." As state an[illegible] regulators began inve[illegible] tions of the company[illegible] two men battled to a [illegible] Ultimately, control p[illegible] into the hands of a [illegible] known outsider, fina[illegible] Thomas Fortune Ryan[illegible] bought out Hyde's int[illegible] Alexander was ousted [illegible] the company. In 1906, [illegible] went into exile in I[illegible] where he married an[illegible] vorced a succession of A[illegible] ican heiresses, returni[illegible] New York only in 1941. He died in [illegible]

Beard begins her tale by asking [illegible] "acknowledge the power of glam[illegible] Certainly, we recognize its embodi[illegible] in James Hazen Hyde—a Gatsby-li[illegible] pher who seemed to grow more b[illegible] ful as he aged. But Beard does not [illegible] bring her protagonist to life. W[illegible] more, although she attempts to d[illegible] the various financial shenanigans a[illegible] Equitable, it's clear she is much mo[illegible] terested in describing society high[illegible] *After the Ball* might have been b[illegible] had it stuck to the ball alone.

BY ROBERT J. ROSENI[illegible]
Rosenberg follows the ma[illegible]

BusinessWeek online
This month's BusinessWeek Best-Seller is available online at businessweek.com/magazine/extra.ht[illegible]

A 1905 CHAMPAGNE SOIREE TOUCHED OFF A BATTLE ROYAL FOR CONTROL OF THE EQUITABL[illegible]

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BY STEPHEN H. WILDSTROM
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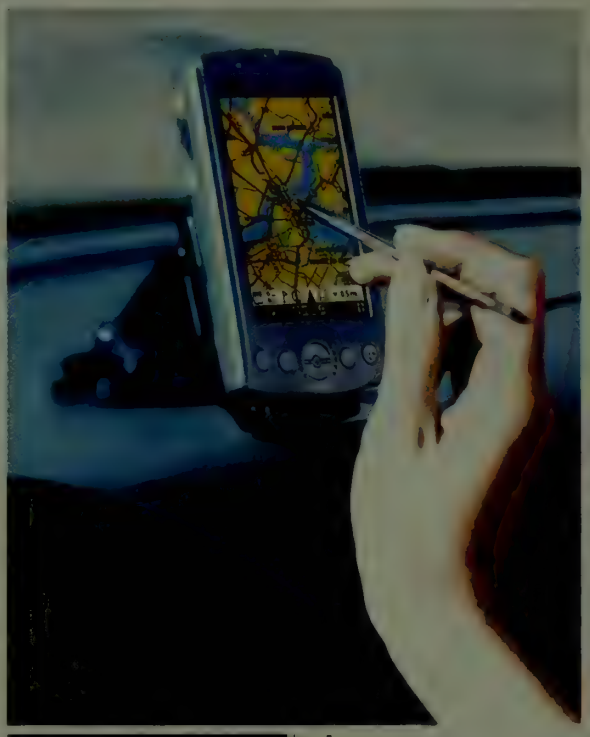
A HANDHELD THAT KNOWS WHERE IT IS

Garmin's iQue 3600 adds mapping and GPS smarts to standard Palm applications

Combining a global positioning system (GPS) receiver with a Palm or Pocket PC has always struck me as a natural marriage. But I have been disappointed by a stream of clunky GPS add-ons that did little or nothing with the possibilities created by a handheld that would always know where it was.

Garmin International's iQue 3600 ($589), a sleek handheld based on PalmSource software, finally makes the match work by thoroughly integrating GPS into the operation of the device. It's an attractive piece of hardware, a bit thicker than most Palms. An antenna recessed into the back of the unit flips up to activate the GPS system. The sharp, bright 2¼-in.-by-3¼-in. screen is legible even in strong sunlight. The device runs on the latest version of the Palm software, which supports a high-resolution, 320-by-480-pixel screen and a fast Motorola processor. The pairing overcomes the trouble earlier Palms had in generating maps quickly and displaying them with enough detail.



AT THE READY
The iQue's weighted pad holds it firmly atop the dashboard

The real wizardry, though, is in the software, since Garmin adds mapping and geographic knowledge to the standard Palm applications. For example, you can tap on an entry in your address book and, if you have the detailed map data for the region loaded, the iQue will pinpoint the location of that address. A couple more taps and it will compute driving or, if you prefer, walking instructions to the spot.

There are some nice touches for auto navigation, too. Instead of the iffy clamps and suction cups often used to mount a handheld on the dash or a window, the iQue offers a mount built on a flexible, weighted pad that holds the unit firmly on top of the dashboard (photo). It's handy, but the $80 price tag for the accessory is steep.

As you drive or walk, you can either ha
iQue follow your progress on a map (v
choice of scales ranging from a couple
blocks on a screen to the entire U.S.) o
you turn-by-turn instructions, both on-
and spoken.

The iQue software is not really design
trip planning or cross-country navigation.
ning a trip is really a job for a big scree
desktop or on a notebook, and the iQue
such basic trip-planning features as the ab
print maps of your route. For trip planning
bined with navigation, I recommend Trav
Software's CoPilot for the Pocket PC, pri
$229. Combine CoPilot with a GPS add-o
the cost is around $350. The iQue, however,
cellent for getting around metropolitan
But watch out: GPS is a power-hungry techn
If you use the iQue extensively away f
car and its 12-volt power supply, you'll w
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of the 32 megabytes of internal memory,
want to store maps on an SD memory card

As good as the iQue software is, the b
yet to come. Garmin is publishing the spe
tions software developers need to take adva
of GPS information in their own applications
will permit the creation of specialized prog
both by the army of independent Palm de
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tom applications.

Sales of handhelds have declined for the
couple of years, and some believe that mo
pable wireless phones are so attractive t
sumers that PDAs are doomed. The iQue
that there are some useful things you can
do with a handheld, and that there is plen
life and innovation left in these products.

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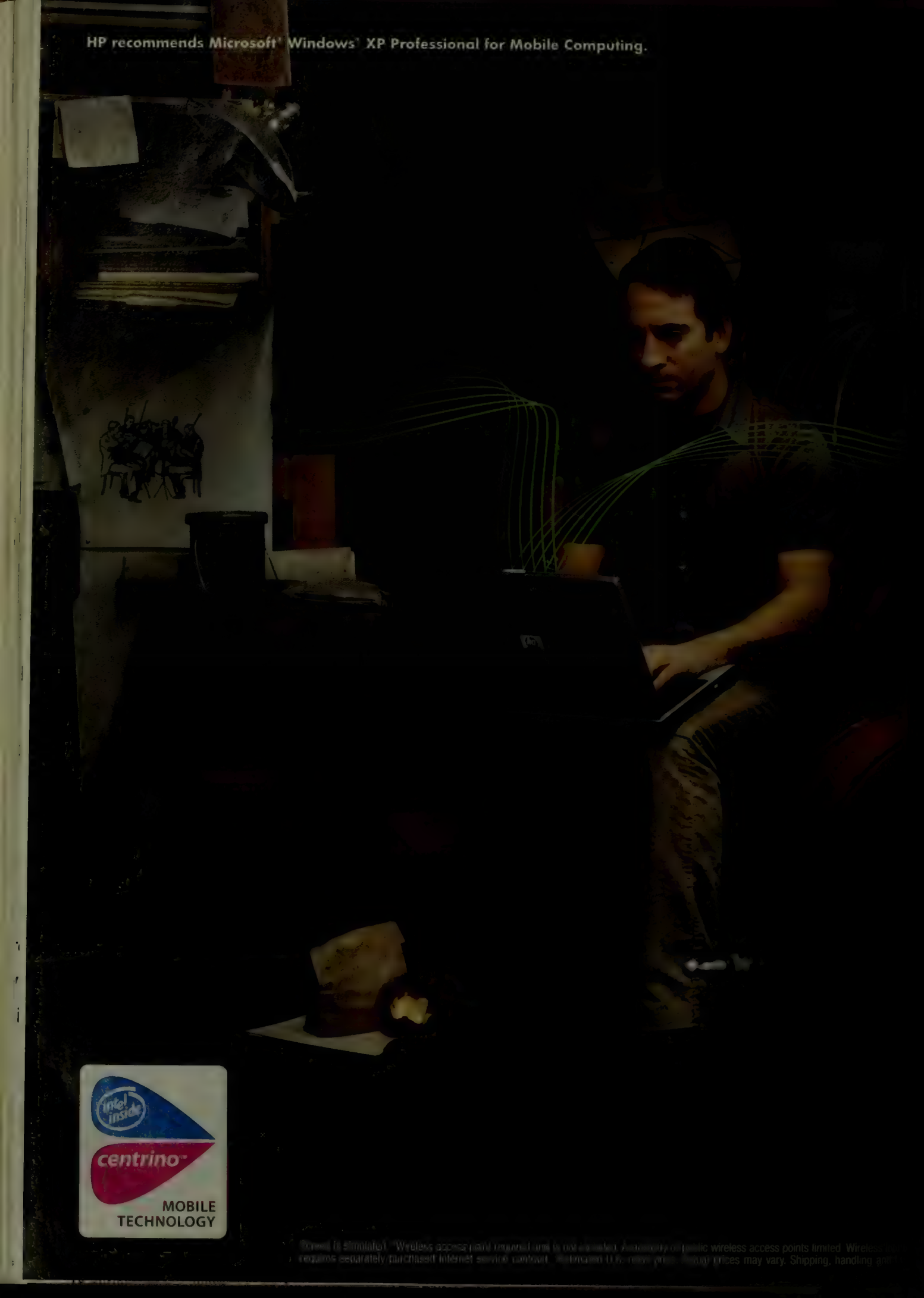
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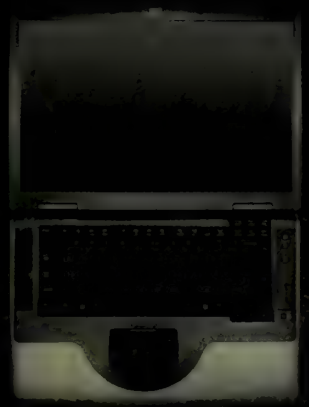

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BY LAURA D'ANDREA TYSON

THE BUSH TAX CUTS ARE SAPPING AMERICA'S STRENGTH

OUCH!
The cost is nearly three times as much as the tab from September 11, Afghanistan, Iraq, and homeland security combined

When George W. Bush became President, the federal government enjoyed a projected 10-year budget surplus of $5.6 trillion. Today, less than three years later, Washington confronts sizable annual budget deficits regardless of the cyclical ups and downs of the economy. A growing number of private forecasters now predict a 10-year deficit of around $4 trillion—$6.7 trillion excluding the Social Security surplus. Government debt and interest payments are slated to double as a share of the economy over the next decade, crowding out private investment and government spending on anything else.

President Bush claims that the economic slowdown and the war on terrorism have triggered the nation's fiscal woes. But they are only part of the story. According to the Congressional Budget Office, over the next two years, the Bush tax cuts enacted since 2001 will cost nearly three times as much as the fighting and occupation in Afghanistan and Iraq, reconstruction and relief after September 11, and homeland security combined. What's more, these tax cuts are scheduled to explode, totaling $2 trillion over the decade. And that's assuming the sunset provisions phasing them out are enacted. If, as seems likely, they are not, the 10-year budgetary costs of the tax cuts will rise by another $2 trillion.

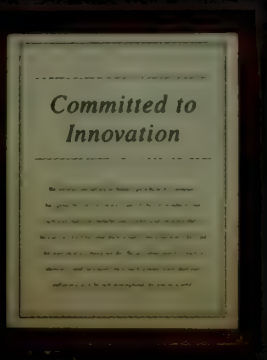
The Administration argues that its tax cuts are necessary to stimulate growth in a sluggish economy. But this argument is specious. The economy may have needed a temporary infusion of additional demand during the past three years. But temporary tax cuts or spending hikes for hard-pressed working families, unemployed workers, and state governments would have stimulated demand much more effectively than tax cuts for the rich. The Administration has also made misleading comments about the size of the tax benefits people will receive from the 2003 tax package. Although the average tax cut is about $1,000, that's because the tax breaks for the richest Americans are so large. More than half of all American taxpayers will get a reduction of less than $120 per year over the next two years. More than a third of taxpayers will get nothing.

And those long-term "supply-side" growth benefits? Even the Republican-controlled Joint Committee on Taxation, using a variety of dynamic scoring assumptions, was forced to admit that these cuts are likely to reduce the economy's long-term growth. Why? Any positive business-investment incentives from lower taxes will be outweighed by the curtailing of national saving and investment caused by mammoth b deficits. To the extent that larger deficits ish domestic saving, they eat into producti vestment. To the extent that larger defici funded by borrowing from the rest of the they raise the nation's foreign debt and future income into servicing this debt. Co to the claims of Administration ideologues er deficits mean lower future living stand

Some Republicans genuinely desire ta and bigger deficits to force lower gover spending. Certainly, the federal governmen fronts a shrinking revenue stream. In 2003 federal revenues as a share of the econom fall to their lowest level since the end Eisenhower Administration. Federal incom revenues as a share of the economy will levels not experienced since 1943, when grams such as Medicaid and Medicare even exist. One out of every three dolla federal government now spends outside th funded Social Security system must cur be financed by borrowing. This is the l share of deficit-financed spending in the l years. If the deficit hits $400 billion by 20 many analysts predict, and if Social Sec Medicare, defense, and interest payments debt are spared the budgetary axe, gover spending on everything else—from educat homeland security—would have to be sl by more than 80% to restore budgetary ba Unless some of the tax cuts are rescinde nation will encounter a grim choice bet large deficits and lower living standards o one hand or deep cuts in Medicare and Soci curity—just as baby boomers begin to ret

Over the past three years, the Admin tion has served its ideological and wealthy paign supporters well. Payroll taxes that the heaviest tax burden for most American ilies have been left untouched while the top ginal income tax rate, the capital-gains ta the dividend tax have been reduced. A same time, the government has been starv revenue to honor its entitlement commitme the middle class and its means-tested co ments to the poor and disadvantaged. Ev they attack the Democrats for inciting class fare, the President and his congressional have been waging it with a vengeance. Americans, especially those with low inc do not vote. As Americans consider wheth vote in 2004, they should ask: Are they bett now? Will they be better off in the long run most Americans, the answer is no.

Laura D'Andrea Tyson is dean of London Business School.



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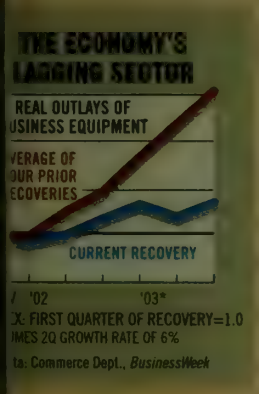
SF/E/2

AMES C. COOPER & KATHLEEN MADIGAN

S CORPORATE AMERICA OO LEAN?

er three years of cutbacks, it may not be ready for stronger demand

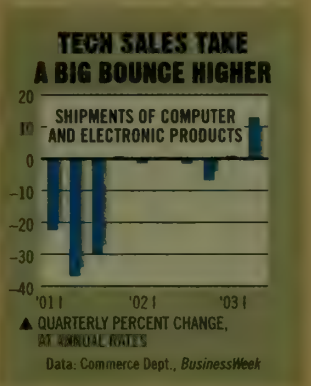
U.S. ECONOMY For three years, Corporate America has been besieged by g stock prices, scandals, investor distrust, war, the unprecedented uncertainty hanging over it all. trategy: Cut everything to the bone and wait for r days. Now the onslaught is beginning to lift, but esses may soon face a new problem. They could be requipped to cope with a more vigorous economy. d guess what? That's good for the outlook. After ing capital budgets, capacity, inventories, and labor , many companies may well be too lean. Given brightening prospects for a stronger second half, nesses may suddenly find themselves unable to demand. That might just provide the spark need- rekindle executives' confidence in the future and er a new round of capital and payroll expansion, of which are crucial to a true economic recovery.



The need to lift output is already becoming evident, as are the pressures to boost stockpiles of goods and outlays for new equipment. Commodity prices are up to a three-year high, always a sure sign of stronger demand, and manufacturing output is up for two months in a row. Another good omen: New factory orders are coming in faster than nents are going out. So the backlog of unfilled or- is finally rising, even as inventories are falling.

ce the bust began in 2000, businesses have ag- ively reshaped their operations to be able to make y in a lackluster economy. And they have been ssful (story, page 72). Profit margins are up and ngs in 2003 look surprisingly strong. As demand nues to accelerate in coming months, earnings will even stronger results. However, in order for busi- s to take full advantage of their new opportunities, t will have to expand in sync with sales, and will mean expanding capacity as well.

RECOVERY BEGAN at the end of 2001, but busi- outlays for equipment have grown only 3.5%, ared with an average of 15.3% during the first and a half of the previous four recessions, ex- g the short-lived 1980 upturn (chart). As a result, s to cut capacity pushed outlays for new equipment and buildings down to only 10.3% of gross domestic product in the first quarter. That's an unusually low level this far into a recovery, and it is inconsistent with companies' long-term needs to boost productivity.



Manufacturers have led the way in mothballing facilities. Production capacity outside of tech equipment actually stopped growing in late 2001, after increasing 4% per year in the late 1990s. In June, 2003, capacity was no higher than it was two years ago. In high-tech industries—including computers, peripherals, communications equipment, and semiconductors—production capacity, which was growing 40% annually three years ago, is now increasing only 8% per year. Tech output is rising faster than that, meaning operating rates, while still very low, are starting to edge up for the first time in three years.

The slowdown in additions to the capital stock mean that existing business equipment and buildings are wearing out at a historically rapid pace compared with new capital spending. In 2002, the ratio of new outlays to depreciation among nonfinancial corporations was the lowest of any year since World War II. That low ratio also reflects the growing dominance of tech gear in the capital stock. Tech accounts for almost half of all new equipment outlays and has a shorter useful life than traditional machinery.

EVENTUALLY, COMPANIES will feel the need to replace their worn-out equipment. In fact, the switch from mothballing to modernizing may be starting. For the entire second quarter, shipments of capital goods, excluding the volatile aircraft sector, showed the largest quarterly advance in three years. Increased shipments of tech gear led the way, with a gain of 13% at an annual rate, also the fastest pace in three years (chart).

Plus, new orders for non-aircraft capital goods in May and June posted their first back-to-back increases in more than a year. Equipment orders are now outpacing shipments, meaning that unfilled orders for capital goods have increased for six months in a row. That's the first sustained rise since 2000. At the same time, inventories of capital goods continue to shrink. The mix of falling inventories and a rising order back-

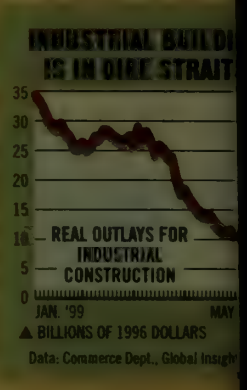
log is a sure ticket to faster production of capital goods. Those output pressures will only grow as overall demand picks up steam in the second half.

ALL THE NEWS on capital spending is not good, however: The outlook for new business construction, which accounts for about 20% of all capital outlays, remains bleak. But even here the news is better than it has been.

Inflation-adjusted outlays for the construction of industrial and commercial buildings in May stood 12.5% below their year-ago level, but outlays are now off their December low point and appear to be stabilizing. From early 2001 to December of last year, spending on new construction fell by a stunning 39.8%. The best that can be said about nonresidential construction is that going forward, it will not be as great a drag on economic growth as it was in 2001 and 2002.

Some of the worst weakness is in industrial building, which accounts for less than 10% of nonresidential building. Industrial construction has been tanking because of the long recession in manufacturing. Real spending in this sector stood at a record low $10.6 billion in May. That represents a collapse of 69.2% since 1999. Even during the severe recessions of 1973-75 and 1981-82, the declines in industrial construction were only 30.9% and 48.6%, respectively.

The latest data from the Federal Reserve show that 25.7% of industrial capacity is still idle, and vac rates for industrial buildings stood at a peak of 11.5 the first quarter. Companies will move their equipment into this empty floor space before they out for new building projects.



Commercial real estate is faring slightly better. The weakness here is centered in office construction. Vacancy rates are still rising, so it's no surprise that office construction is down 16.6% from a year ago. Spending on other commercial buildings, including retail space, has held steady since late 2002. And hotel construction is edging higher. Nevertheless, business construction will likely be one of the last sectors to join the recove

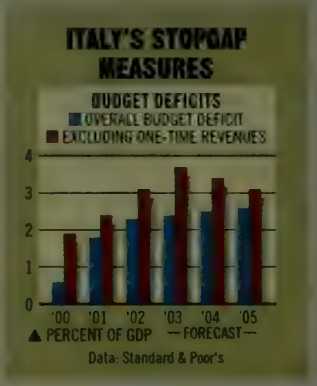
New hiring will come back slowly, too. Yet, though productivity gains have accounted for the of economic growth so far in the recovery, busine will not be able to meet an accelerated pace of mand solely with their existing workforces. At s point, payrolls will start to look too lean as well. A solid pickup in job growth will be the last sign businesses have shed their hunker-down mentality are participating fully in a faster-paced recovery.

ITALY

ONE-TIME FIXES WON'T DO THE TRICK

In July, the Italian government released its budget blueprint for the next four years. Once again, one-time sources of revenues are expected to keep budget deficits down.

Ahead of the wrangling in the fall over the 2004 budget, the government laid out its game plan. Prime Minister Silvio Berlusconi wants to lower next year's budget deficit to 1.8% of gross domestic product, from a forecast 2.4% this year (chart) and well under the euro zone's ceiling of 3% of GDP. A big chunk of the money is to come from one-time revenues like state asset sales, tax amnesty payments, and securitization of real estate sales.



Without those revenues, Standard & Poor's calculates, next year's deficit would be 3.4% of GDP.

The government also lowered its economic growth forecast to 0.8% this year, and 2% in 2004. In addition, it warned that measures to contain the deficit could slow the economy further. The Italian economic think tank ISAE expects GDP will rise a smaller 0.6% in 2003 and 1.8% next year.

Right now, the economy seems stuck in neutral. Second-quarter GDP is expected to be flat, after shrinking 0.1% in the first three months. Business confidence in July fell to an 18-month low, with the three-month outlook on production and orders dropping. Industrial orders were already down 1.1% in May. Consumer c fidence did inch up in July, but a weak economy still has consume leery of buying big-ticket items such as houses and cars.

The biggest disappointment from the budget news, however, was the absence of pension reform plans. Current public-secto pension payments are near 15% GDP, the highest among all euro zone countries. But Berlusconi is not pushing too hard. When he was Prime Minister in 1994, his proposed pension reforms helped bring down his government. Nov he faces opposition within his cu rent coalition. With Italy's rapidl aging population, pension reform are needed. Otherwise, reducing budget deficits will become increasingly more difficult.

By James Mehring in New Yo

TECHNOLOGY IN ACTION

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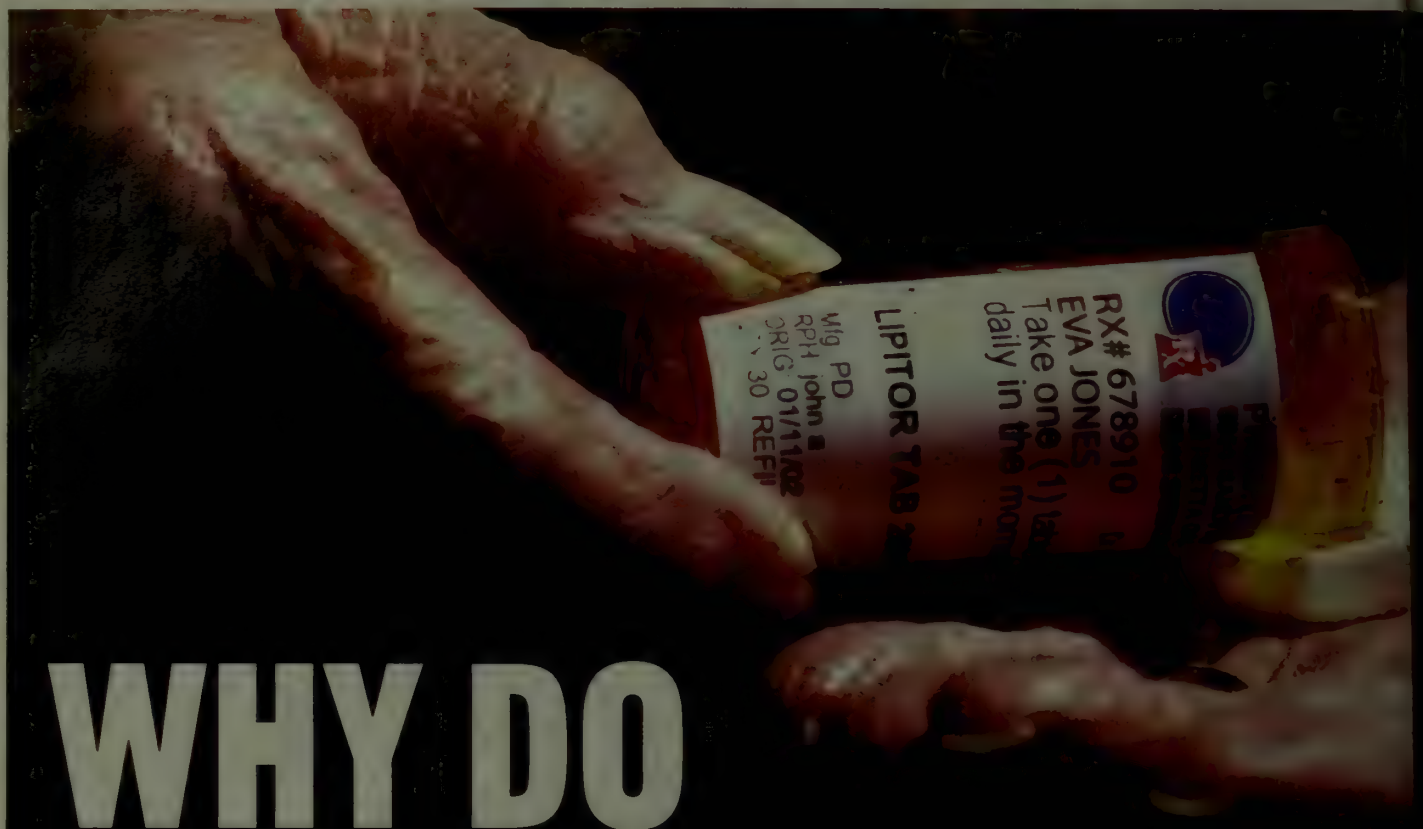

WHY DO WE PAY MORE?

Congress' push to allow drug imports may fade, but consumer ire won't

Even Big Pharma's legendary political clout has proven no match for the anger of ordinary folk over escalating costs at the drugstore. The industry thought its heated lobbying, hefty campaign contributions, and White House backing could quash Capitol Hill's drive to allow Americans to import drugs from countries with far lower prices. But in an early morning vote on July 25, the House handed the industry a stunning rebuke—a 243-to-186 vote on a bill that opens the door to widespread imports. "The will of the Congress spoke," says Representative Jo Ann Emerson (R-Mo.), who led the fight. "The American people want relief."

The vote shines a harsh light on the prices Americans pay for medicines—often more than twice what Canadians or Europeans face. "American consumers are footing the bill for R&D while consumers in other countries get the benefit," says Senator Susan M. Collins (R-Me.), a key Senate supporter of drug imports. "I don't think that's fair."

The price disparity has already spawned scores of storefronts across the country and hundreds of Web sites offering U.S. residents cheaper drugs from Canada and elsewhere. And if Congress gives the green light to imports, the impact on Big Pharma's prices—and profits—could be huge. Even if imports were limited to products from Canada, Senator Byron L. Dorgan (D-N.D.) pegs the savings for consumers at up to $38 billion a year, most of which will come out of drugmakers' pockets.

Mounting pressure to lower drug prices through imports comes at a time when the industry is already suffering from a paucity of new drugs coming out of the pipeline and from top-selling medicines going off patent, ushering in competition from cheaper generics. its are also under threat as poor tries such as Mexico increasingly for the right to manufacture and far cheaper drugs (page 28). In thi vironment, allowing drug imp "would have a devastating impac the pharmaceutical industry's pro says independent analyst Heman Shah.

No one expects the House bill, w would open the U.S. to imports fro specified countries, to become la

Yowza!

Where You Live Determines How Much You Pay...*

* Based on sample prices
** Locally manufactured generic versions

Data: drugstore.com, canadianshop.com, Comite Economique des Produits de Sante, Indian Medical Assn.

n. But the vote virtually guaran-
hat any bill Congress manages to
nis year adding a drug benefit to
are will include a plan to let
icans buy cheaper drugs from be-
U.S. borders. That's because the
-passed version of the Medicare
ready has a provision that per-
nports from Canada—as long as
deral government can ensure the
safety. "The House vote has gen-
huge momentum," says Repre-
ive Bernard Sanders (I-Vt).

Still, a federal guarantee that imported drugs are safe remains a big "if." Congress passed a similar law allowing imports in 2000, provided the Health & Human Services Dept. could guarantee their safety. But HHS refused to sign off. HHS officials say they won't allow imports this time, either, because, they argue, such drugs would be too risky for consumers. Food & Drug Administration policy chief William K. Hubbard points to drugs ordered from Canada that weren't refrigerated as required or which were actually made in India. "The consumer is totally at the mercy of the person on the other end," he says.

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If the HHS and FDA refuse to certify that drugs can be imported safely, according to the current Senate measure, the plan would go nowhere. That's why some political hands argue that members who passed the House bill got a free vote: They can tell constituents they took a stand for cheaper drugs even though nothing will change. "This is an illusory promise," says Ira S. Loss, senior health-care analyst for Washington Analysis LLC. But "there is such hunger for solutions to these problems with pharmaceuticals that people latch onto things that are illusory."

Still, there may be enough momentum this time to pass a measure without the HHS requirement, thus forcing regulators and the industry to swallow imported pills. Supporters in Congress argue that a carefully crafted bill could solve the safety problems. After all, imports are already routine in Europe, where middlemen buy drugs in countries with lower prices, such as Spain, and repackage them for resale in nations with higher prices. Moreover, the current Senate bill allows only imports from FDA-approved facilities, and only from Canada. "That removes most of the legitimate safety issues," argues Senator Collins. Indeed, while the House bill covers 25 countries, its backers see Canada as their opening wedge. "I think a compromise could be something like drug importation with Canada," says Emerson. "We'll see if it works, and then expand it to the European Union."

Big Pharma, of course, is gearing up to fight the importation bills at every turn. Its lobbyists insist that Americans would be at risk. They argue that the real solution to high costs is helping people pay for drugs via better insurance—including a Medicare drug benefit. "Far too many people can't afford drugs because they don't have prescription-drug coverage," says Jeff Trewhitt, spokesman for Pharmaceutical Research & Manufacturers of America (PhRMA).

What's more, suggests David R. Brennan, president and chief executive of AstraZeneca U.S., a Medicare drug benefit would reduce average prices in the U.S. The main reason why prices are lower in Canada and Europe is that governments use their huge bargaining power to win big discounts. Even in the U.S., drug prices vary widely because organizations with clout, such as the government, big health-maintenance organizations, and employers, negotiate big savings. A Medicare drug plan would bring such negotiated discounts to the vast market of elderly Americans, Brennan says. So allowing imports wouldn't provide that much additional savings.

Drugmakers are also contemplating strategies to get around any importation bill. If the law required that all drugs imported from, say, Canada, be made

in FDA-approved facilities, then drugs designated for sale in Canada could be made in plants purposely removed from FDA purview. "It's simple to defeat the intent of the bill," says Richard T. Evans, a pharmaceutical analyst at Sanford C. Bernstein & Co.

Maybe so. But clearly, the industry can't put this issue back in the bottle. Whatever Congress finally does, outrage over high drug costs has already led many Americans to buy their drugs from other countries. Hans W. Jenau, founder of a storefront in Oviedo, Fla., that helps seniors buy from Canadian pharmacies, reports that 10,000 people have used his service since he opened in June, 2002. Overall, House investigators put the number of import shipments at more than 20 million a year, up from 2 million just two years ago. While that represents just 1% to 2% of the nation's $240 billion drug bill, it's likely to keep growing rapidly.

That's why the House vote is just the latest indication that rising drug costs have put Big Pharma on t fensive. "This was a sign that prices are unconscionable—and th industry is not as powerful as it th it was," says James Packard Lo rector of the Consumer Project on nology. No amount of drugmake bying or campaign contribution keep Americans from seeking ch drugs wherever they can find the

By John Carey, with Alex Starr, in Washington, and Amy I in Philadelphia

DRUGMAKERS FEEL THE HEAT IN MEXICO

Víctor González Torres sure doesn't look like the kind of guy who could strike fear in the heart of the U.S. and European drug industry. A jovial 56-year-old Mexican, González is president of Farmacias Similares, a fast-growing drugstore chain based in Mexico City. González has a charitable streak that's also good for business. His 1,050 pharmacies cater to some 50 million uninsured Mexicans. Under the banner "the same, but cheaper," the stores sell knockoffs of widely prescribed off-patent drugs, often for one-fourth the price charged by rivals. "Our main competition is the Virgin of Guadalupe, to whom people pray because they cannot afford to buy medicine," says González.

Doing well by doing good: What's wrong with that? But González, whose pharmacy chain and drugmaking laboratory racked up $200 million in sales last year, is also pushing for a major change in Mexican law. In September, the Senate will consider whether to allow the compulsory licensing of drugs used to treat illnesses such as AIDS and cancer. That means the government could grant local laboratories licenses to churn out cheap copies of patented drugs, whether Pfizer, Merck, or Eli Lilly like it or not. In exchange, the holder of the patent would get a modest royalty payment. That's no compensation for the profits Big Pharma stands to lose if the law passes. Mexico is the fastest-growing drug market in Latin America, with more than $7 billion in 2002 sales.

The prospect of losing a chunk of a big market isn't the only problem drug companies face. Using his marketing savvy and connections, González has turned Mexico into another battleground in a global drug war that pits poor countries against rich. In South Africa, India, and Brazil, activists and politicians have clashed with drugmakers and forced down prices for life-saving treatments. In the U.S., there's mounting concern that a defeat for intellectual-property rights in Mexico might embolden other countries. "We're watching this closely," says an official at the U.S. Trade Representative's office.

CLINIC: Are cheap copies of patented drugs on the way?

No surprise, then, that foreign drugmakers want to block the law. "It is populist and shortsighted," says Victor Manuel Miguelez, general director of Grupo Roche Syntex de México, who argues that efforts to circumvent patents could hamper innovation if they spread worldwide. "If compulsory licensing is passed, pha maceutical investments could be frozen in Mexico," adds Julio E. Po tales, director of corporate affairs f Eli Lilly's Mexico subsidiary. When Brazil enacted similar legislation, E Lilly withdrew some of its drugs fr the market. Yet activists point out that since Brazilian gove ment labs began produci generic versions of sever AIDS drugs in 1997, U.S. and European drugmake have dropped prices on some products by as mu as 65%.

González is pulling out all the stops. His nephew heads a small political pa ty, the Greens, that has a lied with members of the powerful Institutional Re olutionary Party to push for the legislation's passa González is also doing ch ity-cum-public relations: His foundation runs 200 clinics that distribute me cine free to the poor. He already m aged to get one version of the licen ing law passed in the lower house i April. "The lobbying from both side was intense," recalls Silvia Alvarez, congresswoman from the ruling Na tional Action Party.

González' customers understandably care only about their wallets. "Private doctors and hospitals are the rich," says Jorge Ruiz. To treat his son's ear infection, the unemployed technician paid $11 at a Farmacias Similares for medicines that would have cost $50 elsewhere. Tha a price difference González is shrew ly exploiting.

By Geri Smith in Mexico C

COMMENTARY

By Emily Thornton and Mike France

FOR ENRON'S BANKERS, A 'GET OUT OF JAIL FREE' CARD

The irony was hard to miss. When securities cops announced a $300 million settlement with Citigroup d J.P. Morgan Chase & Co. for eir role in the Enron escapades, ey said putting the responsible nkers in jail would have been all t impossible. "We have to show in- it to commit fraud, and we didn't nk we could show that here," nhattan District Attorney Robert rgenthau explained at a July 28 vs conference.

The very same day, a mountain of sh evidence arrived indicating that i and J.P. Morgan Chase execs ew exactly what games Enron was ying. In a nearly 1,000-page re- t, bankruptcy examiner Neal Bat- concluded that both banks "had ual knowledge of the wrongful duct in these transactions." ding to the already rich library of oking-gun documents in the case, son quoted from two bankers in i's commodities and derivatives ups who were chatting over e- il about how they both basically the same job for Enron: "manipu- ng cash flows."

So how come these characters n't being prosecuted? Because ting bankers in jail for securities ud is very, very hard in the U.S. vernment lawyers would have had prove the Citi and J.P. Morgan ase hotshots committed willful ud. That means they knew all ut Enron's schemes and actually nted to mislead Enron shareholder—as opposed to, say, knowing t shareholder deception was likely simply wanting to earn big fees. ving that a particular banker was bystander who knows that the fraud is going to happen," wouldn't have sufficed, says John C. Coffee, a securities law professor at Columbia University School of Law.

This may sound like a lot of semantic nonsense. But it has a big impact on securities markets. Because enforcers have a hard time putting bankers, lawyers, accountants, and other "aiders and abettors" behind bars, they're generally forced to fine them for wrongdoing. That means there's a risk that the penalties, however large, will be treated as a cost of doing business. "The message being sent by the regulators is 'write a big enough check and you can get away with anything,'" says Jacob H. Zamanksy, a Manhattan attorney who represents investors.

> "[Citi and J.P. Morgan] had actual knowledge of the wrongful conduct in these transactions"
>
> **NEAL BATSON,**
>
> *Court-appointed bankruptcy examiner*

Certainly Citigroup and J.P. Morgan are writing very big checks. The fines announced by Morgenthau and Securities & Exchange Commission Enforcement Director Stephen M. Cutler are among the biggest ever levied in this type of case. The two financial institutions are likely to shell out more money in private shareholder litigation—and may even lose their rights as creditors to claim unpaid bills of $1.8 billion (J.P. Morgan) and $2.4 billion (Citigroup) from Enron. "You have to take into consideration that the banks ended up to be enormous creditors," says James Kindler, chief assistant district attorney at the Manhattan D.A.'s office. "There's no indication that they knew what kind of shape Enron was in."

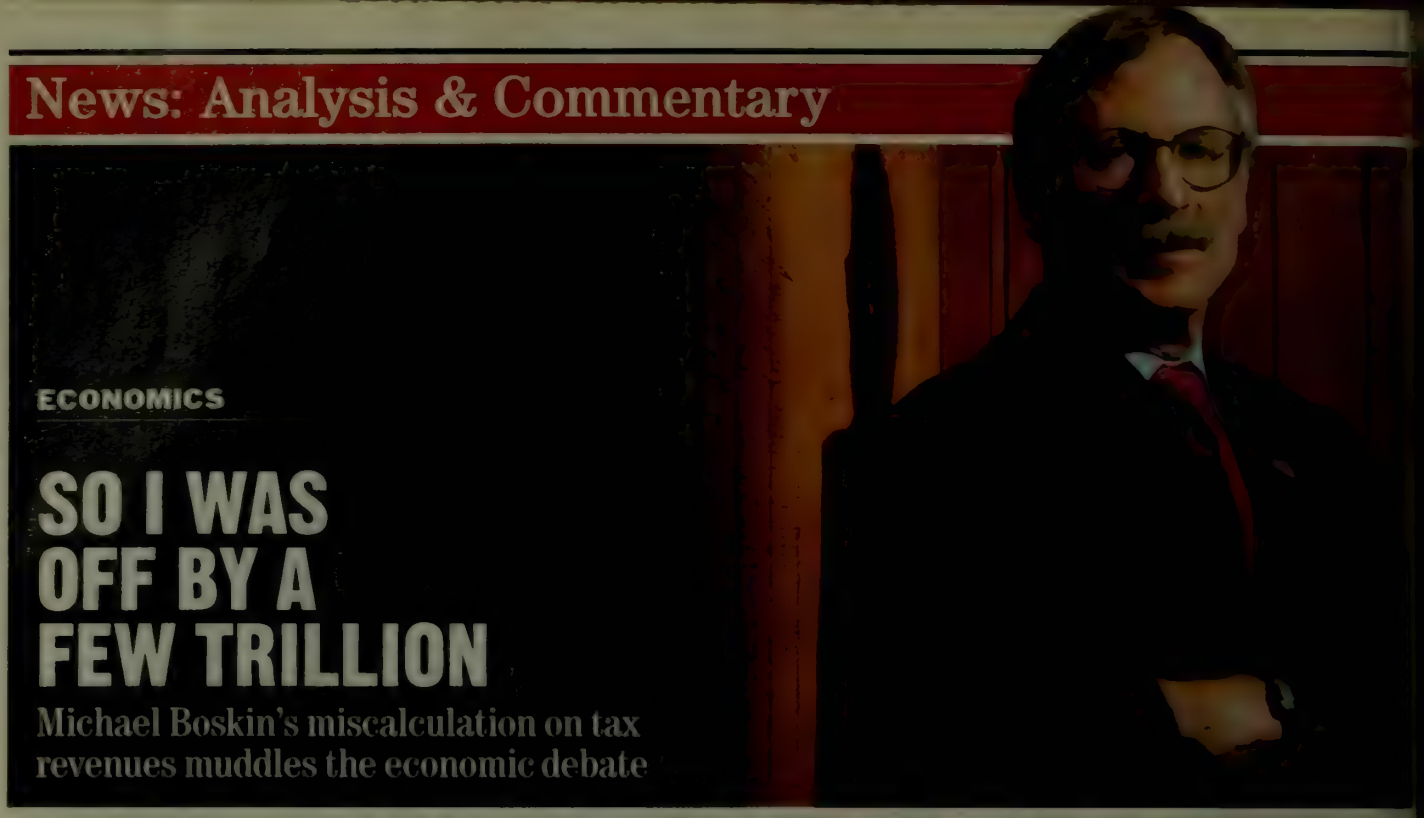
Moreover, individual bankers at both firms are not out of the woods. The Justice Dept. still has Enron criminal investigations under way, and the SEC is holding out the option of filing civil charges against some of the company's financial partners—which could lead to penalties and banishment from the business. "We're still working through the issues" with individual bankers, says a source familiar with the investigation. "We have not closed the door."

But nothing concentrates the mind like the possibility of a cell mate. The fact is that the recent fines represent roughly a week's profit to the banks. Because a portion of the payments will be credited against any liability the banks face in private securities litigation, under a new provision of the Sarbanes-Oxley law, "I don't think there was deterrence in these settlements," says Coffee. "The same money would have gone to the plaintiffs' lawyers."

It's high time to take a closer look at tightening the rules against white-collar crime. If the evidence in the Batson report is not strong enough to lock up some of Enron's bankers, then the legal standards should be revisited. This is a long-term, complex project. But as things now stand, it feels as if Charles Ponzi himself probably wouldn't do time.

With Mara Der Hovanesian in New York, Mike McNamee and Lorraine Woellert in Washington

MORGENTHAU, RIGHT, AND CUTLER ANNOUNCE THE SETTLEMENT



ECONOMICS

SO I WAS OFF BY A FEW TRILLION

Michael Boskin's miscalculation on tax revenues muddles the economic debate

Did you ever make a mistake that was so large and so public that it made you want to crawl under your bed? If so, you can imagine how Michael Boskin feels these days.

Earlier this summer, Boskin, a highly respected Stanford University economist who was head of the Council of Economic Advisers under George H.W. Bush, electronically circulated a startling paper to fellow economists. In it, he argued that the future tax payments on withdrawals from tax-deferred retirement accounts, such as 401(k)s and employer pension plans, were being drastically undercounted. That meant federal budget revenues could potentially be in for a huge, unforeseen windfall. The underestimate over the next 40 years—almost $12 trillion, in today's dollars—was so big, Boskin wrote at the time, that it was "larger than the sum of the 75-year actuarial deficits in Social Security and Medicare plus the national debt."

With such sweeping claims coming from such a reputable economist, Boskin's paper quickly drew widespread attention. The June 30, 2003, issue of *BusinessWeek*, for one, reported that "Boskin's paper has the potential to shake up the budget debate."

But as the paper received increasing scrutiny, it sparked a huge controversy and came under sharp criticism from fellow economists who argued that the savings would be nowhere near what Boskin predicted. He took another look at his numbers and concluded that he had made a serious mistake: A key term had been left out of a complicated calculation of the effect of tax deferral on future savings and business investment, possibly wiping out most of the estimated $12 trillion in savings. In mid-July, Boskin sent an e-mail notifying recipients of the paper about the error. "I apologize for any inconvenience this may have caused you," he wrote.

Boskin is now redoing his calculations, both to fix the mistake and to take the criticisms into account. But the debate is far from over. Boskin still argues that some of the revenues from deferred taxes are not being counted in long-term budget projections, but he's not willing to hazard a guess about the magnitude until he has had a chance to redo—and double-check—his figures.

His critics won't even grant him that much. They argue that even if deferred taxes are undercounted, the sum is too small to affect the enormous fiscal gap projected between long-term revenues and outlays. "The projections of revenues for tax-deferred accounts don't alter the fiscal picture in any significant way," says William G. Gale of the Urban-Brookings Tax Policy Center. Gale, along with Alan Auerbach of the University of California at Berkeley and Peter R. Orszag of the Urban-Brookings Center, wrote a stinging rebuttal to Boskin's paper after it was report the media. Other economists have challenged Boskin on a host of is such as overstating the tax rat withdrawals, using the wrong inte rate assumptions to value future t and underestimating the deferred already counted in long-term bu projections.

> The moral: Even the best economists can slip up making fiscal projections 40 years into the future

If there is a moral to this tale c missing trillions, it is that making projections 40 years ahead is a complicated and perilous business, for the best economists. Even whe calculations aren't in dispute, the clusions can depend as much on pol assumptions as on economic reaso

Consider one of the thorniest p lems under dispute: figuring out much of the deferred taxes are alr counted in existing revenue projec Sound simple? Hardly. For example Congressional Budget Office's long- projections assume, based on histo averages, that no more than 19 gross domestic product would go to eral revenues. However, the projec don't specify which taxes would ge ate the future revenues. So to d mine how much of the total repres deferred taxes, economists have to m assumptions about what people wil into retirement accounts, what th take out, and what the tax laws look like in 40 years. All that call plenty of difficult assuming.

Boskin says he has received sy thetic calls from fellow econom telling of similar mistakes—caught, ever, before being published. For man who projected the $12 trillion w fall that wasn't, that's slim consola

By Michael J. Mandel in New

COMMENTARY

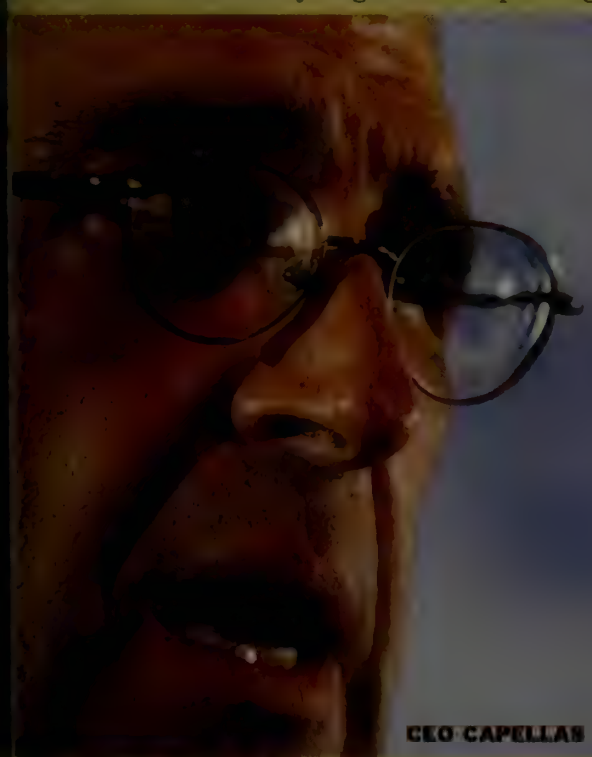
By Steve Rosenbush & Charles Haddad

MCI IS UNDER A NEW CLOUD, BUT IT CAN WEATHER THE STORM

When Michael D. Capellas signed on as chief executive of WorldCom Inc., his track record and siness smarts seemed just what the ndal-riddled company needed. And e to form, Capellas moved swiftly get beyond the company's account- mess and $80 billion writedown. now, just eight months after tak- the job, Capellas is being by a new WorldCom scan- that could threaten his ns to lead the company out Chapter 11 bankruptcy tection by October.

Rivals allege that WorldCom, now amed MCI, has avoided perhaps as ch as hundreds of millions of dol- in fees over a decade by disguising long-distance calls as local calls or alls originated by long-distance petitor AT&T. The U.S. Attorney's ce in New York has launched a be into the matter even as com- tors turn up the heat. SBC Com- nications Inc. now says it has ed the issue of fees three times h MCI over the past year, sending letters directly to Capellas in il and June. And on July 28, AT&T eatened to file a lawsuit alleging ations of federal anti-racketeering laws. MCI says it is investigating the allegations. "We have a zero-tolerance policy and if any wrongdoing is discovered you can be certain that we will take appropriate action swiftly," responded Capellas in a written statement on July 28.

How big a problem is this for Capellas and MCI? Well, it isn't pretty, but it isn't the end of the world. While the allegations could slow down the timetable for getting out of bankruptcy, there's little chance that those plans will be derailed. Even if MCI is forced to pay back all of the alleged unpaid access fees plus penalties, it's still highly unlikely the company, with its sprawling long-distance network and $24.5 billion in revenue, would be forced out of business. Says Friedman, Billings, Ramsey & Co. analyst Susan Kalla: "This isn't large enough to push the company into liquidation, not even close."



CEO CAPELLAS

CROSSED WIRES

DELAYED RESTRUCTURING
Allegations that MCI illegally avoided access charges to local networks will likely push back a hoped-for October restructuring

SOARING COSTS
A six-month delay, for instance, could cost tens of millions in legal fees

LOST BUSINESS
The allegations could prompt the federal government to shift some or all of $1 billion worth of business to rivals

The controversy stems from telecom's arcane accounting rules. SBC, Verizon, and AT&T say MCI used small carriers to redirect long-distance calls. Their original identifying codes were removed, they say, making it nearly impossible for rivals to charge MCI for completing its calls. MCI maintains that it has already settled previous claims over fees with Verizon Communications Inc. and SBC for $436 million and $107 million, respectively, in July and that it has been negotiating for the past two months to resolve more recent claims.

Now that scandal has erupted, MCI is trying to limit the damage. On July 29, it announced that it hired Washington law firm Gibson, Dunn & Crutcher to lead an internal review. And on the same day Fred Briggs, MCI's president for operations and technology, said MCI will reassess its relationship with least-cost routing companies.

Still, things could get dicey if U.S. Attorney James B. Comey files charges against the long-distance giant. The stigma of criminal charges, which it has avoided so far, could drive away big customers who might be loath to be associated with scandal. The biggest threat: MCI could lose as much as $1 billion in business from its largest customer, the federal government. Even if Comey doesn't press charges, MCI might be compelled to end some of its most aggressive call-routing tactics. If it turns out that those tactics were an essential part of its ability to offer lower prices, big customers might look elsewhere.

Meantime, the longer MCI stays in bankruptcy, the weaker it gets. A delay of six months now looks likely, because creditors may want the new investigation completed before the company emerges from bankruptcy. Otherwise, the company runs the risk of facing liabilities without the protection of the courts. A delay of just six months in implementing the reorg plan could cost tens of millions of dollars in additional legal fees.

So far, Capellas and the company have plenty of support from creditors. "We understand that what MCI did is standard practice," says Mark A. Neporent, co-chair of the MCI creditors committee and chief operating officer of Cerberus Capital Management. "This is nothing but a naked attempt to distract MCI from the goal of emerging from bankruptcy." MCI can only hope the U.S. Attorney's office agrees.

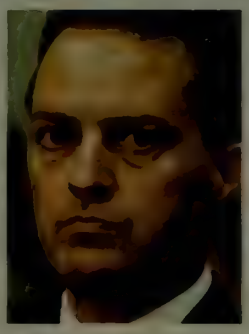
Rosenbush covers the telecom industry from New York and Haddad reports on MCI from Atlanta.

TELECOM

GLOBAL CROSSING: A MATTER OF NATIONAL SECURITY?

Carl Icahn is lobbying to keep it in American hands–his

Carl C. Icahn is on the warpath. In late May the 67-year-old billionaire launched a $700 million hostile offer for bankrupt telecom provider Global Crossing Ltd. Since then he has challenged a rival deal from Singapore Technologies Telemedia in bankruptcy court, lobbied Washington officials to get the Singapore bid disqualified, and spent $165 million putting together a controlling stake in Global Crossing's bank debt. Icahn hopes to merge Global Crossing with XO Communications Inc., a telecom provider he took out of bankruptcy in January, to create a juggernaut out of the industry's rubble. "This is like the railroads in the 1880s," he said shortly after announcing his offer.



CEO JOHN LEGERE

Icahn's robber baron-era analogy may hit too close to home for Global Crossing. The company has branded him a "corporate raider" in bankruptcy-court filings and, worse, charges that one of its own former execs is improperly helping him. Global Crossing says it believes that the exec, onetime CEO Carl J. Grivner, whom Icahn hired to run Reston (Va.)-based XO in April, may have violated his previous employment agreement by sharing confidential information with Icahn. Grivner denies this, but Global Crossing went to court to force Icahn to turn over documents relating to its former executive.

Bankruptcy court is a battlefield few know better than Icahn. The New York City financier became the largest shareholder of Texaco Inc. after its 1987 bankruptcy and later followed Trans World Airlin twice into Chapter 11. But now th has moved onto unfamiliar turf ahn. Busy with his takeover of entered the Global Crossing cont late to dissuade a New York bank court from approving the Singap on July 1. So Icahn is now countin secretive Washington committee considering whether to nix the d national-security grounds. If it Icahn's controlling stake in Global ing's bank debt could give him a back in bankruptcy court.

The 12-member Committee on eign Investment in the U.S. heavyweight as they come. It's c by Treasury Secretary John W. and four of his Cabinet colleagu members, too. A 45-day period the Singapore deal ends in early tember, and then the decision g President George W. Bush, who days to sign off. Foreign comp have purchased telecom assets b but this is the first major deal September 11, and authorities ar cerned that Global Crossing's ne could be used against the U. spies and terrorists. The d ments of Defense and Hom Security are expected t pose the deal, while Stat Commerce will argue in Singapore Technologies, o by the Singapore govern is hanging tough. "The U.S Singapore have been friend allies on so many fronts, I'm optimistic approval will be g ed," says Lee Theng Kiat, the pany's CEO.

The outcome may little to do with gapore. "This be a classic ca whether nati security f override t and economi sire," says C. Clellan, of Washin investment ser Precu Group. "My is they w Global Cr ing to ren American." As rece as last y

BANKRUPTCY BRAWL

Carl Icahn is using every trick to thwart Global Crossing's planned sale to Singapore Technologies Telemedia. Global Crossing is fighting back just as hard.

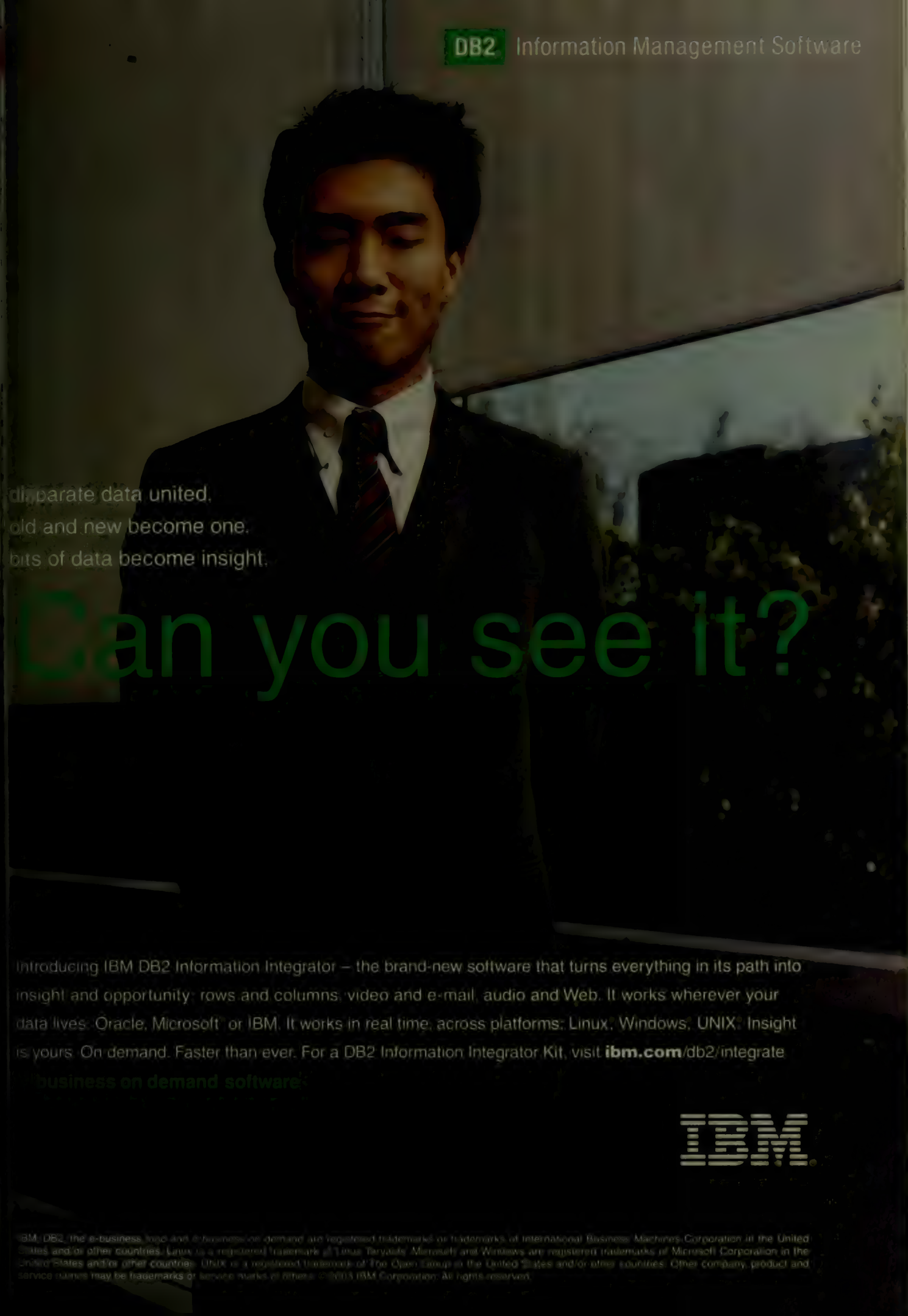
LOBBYING He's raising questions in Washington about foreign ownership of a U.S. telecom. Global Crossing is stressing close U.S.-Singapore ties.

LEGAL WRANGLING He unsuccessfully challenged Global Crossing's reorganization in bankruptcy court. Global Crossing is pressing the court for Icahn documents concerning a former Global Crossing exec.

END RUN After his $700 million hostile offer was rebuffed, Icahn spent $165 million for a controlling block of Global Crossing's bank debt.

Data: Court filings, corporate documents

ICAHN: *Tak the fight to Washington*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Global Crossing didn't seem like a prize worth fighting over. Founded in 1997 to lay high-speed fiber-optic cables under the Atlantic Ocean, Global Crossing built one of the world's largest telecom networks. The company was a stock market darling, valued at $47 billion at its peak, then collapsed into bankruptcy in January, 2002, amid a capacity glut and charges of aggressive accounting. When few bidders emerged in a bankruptcy-court auction last year, Singapore Technologies was able to reduce its offer to take control of the company from $750 million to $250 million.

This year, however, the market for telecom assets is improving. Traffic on Global Crossing's network is up. The company has slashed costs, taking its head count from 8,000 to 4,200. Vik Grover, a telecom analyst at brokerage firm Kaufman Bros., figures that combining Global Crossing's long-haul network with XO's collection of local switches could save as much as $400 million a year in network-access charges and overhead and lift the combined $3.8 billion-a-year company to profitability.

That idea doesn't sit so well, however, with Global Crossing's management and bondholders, who have pressed on with the Singapore investment. In a bankruptcy-court hearing in late June, an attorney for Icahn questioned whether Global Crossing's top execs were supporting the Singapore deal merely to save their jobs and receive equity in the new Global Crossing. But they're likely to receive nothing and be out of work if XO acquires the company. John J. Legere, Global Crossing's CEO, denies that is his motivation. "We believe in the merits of the [Singapore] investment and view it as the best means to emerge from Chapter 11 for all affected parties," he said in a statement.

Global Crossing's bondholders rejected Icahn's offer because they stand to get more from the Singapore deal, according to Igor Volshteyn, an analyst at Tejas Securities Group. They'll get newly issued Global Crossing stock, while bank lenders would receive mostly cash and notes worth about 23¢ on the dollar. Icahn looked at that and starting offering an immediate 22¢ on the dollar for the bank loans. He now owns just over one-third of the debt—enough, under court rules, to block other offers if the Singapore transaction is shot down by federal authorities and returns to bankruptcy court. And that's a place where Icahn is known to win.

By Christopher Palmeri in Los Angeles, with Lorraine Woellert in Washington

TRAVEL

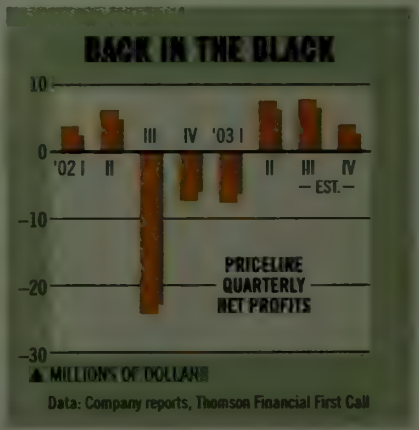
A HUMBLER, HAPPIER PRICELINE

The Web discounter is profitable, but bubble-era boasts are g

BOYD: Can he fend off competitors?

When Priceline announced on July 24 that it had returned to profitability, making $7.7 million—or 20¢ a share—in the second quarter, investors threw a party. Shares leapt $10, to top $35, and the onetime Internet star's market cap climbed back above $1 billion for the first time since 2000.

Priceline's in the black, but is it back? Not if you're expecting its name-your-own-price model to spread to cars or groceries. Those bubble-era dreams are dead. But these days, CEO Jeffery H. Boyd is meeting a more modest target: running a profitable discount travel service focused on leisure travelers. Excluding a $6.7 million noncash charge, analysts expect Priceline to earn $19.7 million in profits this year on $904 million in sales, after losing $21.5 million in 2002 on $1 billion in sales.



Yet even that won't be easy. Boyd is battling tough rivals, led by InterActiveCorp.'s Expedia.com and discount airlines that don't sell through Priceline. The outfit also could become a takeover target. "They grow at about half the rate of other [travel ... says Legg Mason Inc. analyst T... S. Underwood. "They're viabl... they'd also be a good brand addit...

Boyd engineered the comeba... scrubbing much of what made Pr... a boomtime phenom, moving awa... low-margin plane tickets in favor ... ing hotel rooms. With vacancie... 40%, hoteliers are cutting Pricelin... deals. In the second quarter, Pr... sold 446,000 air tickets, off 52% ... year earlier, but hotel sales rose 3... 1.5 million room nights. "We've ch... the mix of our business," Boyd s...

Boyd also dumped nontravel bu... es, including the auto-sales effo... long-distance phone unit. After lay... 65 people in the fourth quarter of ... 15% to 20% of total staff—Pricelin... breaks even on annual sales of $8... lion, down from $1 billion. Of th... travel businesses, only a 49% st... Priceline Mortgage remains; it ad... million-plus to second-quarter pro...

Even a travel-focused Priceline ... from being a market leader. Expe... eight times bigger. In discount t... Priceline is feeling heat from u... Hotwire.com. Its sales are about ... thirds of Priceline's. "Hotwire frag... the market," says Lorraine Sileo, ... president of travel-consulting ... PhoCusWright Inc. in Sherman, ... "And it's not that big a niche."

All this says investors who ha... Priceline up t... times estimated ... profits are tak... risk. But with ... Web travel m... growing some 4... year, they also ... plenty of earning... tential. Some m... betting that Pric... will go on the l... With a well-k... brand, tight lin... hotel suppliers ... say Priceline lets ... discount more selectively than E... dia—plus, once again, profits—Boy... maneuvering room. And if he does ... maybe he can name his own price.

By Timothy J. Mullaney in New...

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customers connect with partners.
today's stuff click with tomorrow's.
Can you see it?
WebSphere Business Integration is far and away the leading integration software for the on demand era. Open and flexible, WebSphere lets you model, integrate and manage all of your business processes. WebSphere delivers an infrastructure that quickly responds to change, meeting business demands, on demand. For an Integration InfoKit and case studies, visit ibm.com/websphere/seeit
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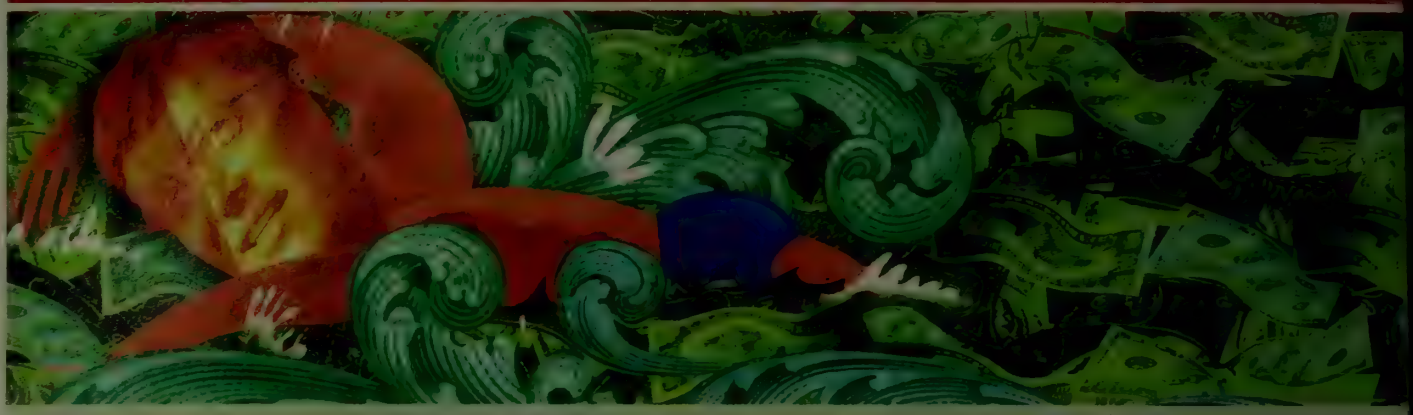

COMMENTARY

By Jay Greene

MICROSOFT'S $49 BILLION 'PROBLEM'

Microsoft has a conundrum that any company would die for: what to do with its $49 billion pile of cash. With the stash amounting to $4.57 a share, it's what Goldman, Sachs & Co. analyst Richard G. Sherlund calls a "high-class problem."

Indeed, despite growing questions from investors about the size of the stockpile, Microsoft Corp. appears in no hurry to solve the dilemma. For now, the software giant has parked most of the money in conservative corporate and government notes and other short-term investments. "We pile it very nicely," Microsoft Chairman William H. Gates III jokes. "It's owned by shareholders. So we treat it very carefully."

Too carefully for some. With the cash growing at a rate of about $1 billion a month, some worry that Microsoft will waste the money on frivolous investments because the sum is so large. Larry J. Puglia, who manages the $6 billion T. Rowe Price Blue Chip Growth Fund, which owns about 10 million Microsoft shares, frets about the outfit "frittering away the money on investments that aren't well thought out."

Investors argue that Microsoft could better enhance shareholder value by raising its 8¢-a-share dividend or by buying back shares. While execs said on July 24 that they would eventually take one or both of those actions, some argue it should happen sooner, not later. "We were disappointed they didn't increase the dividend substantially," Puglia says.

Moreover, the much-publicized $49 billion Microsoft reports as cash and equivalents is only part of the story. That figure includes cash and short-term investments—held for a year or less—as required under generally accepted accounting rules. As of June 30, Microsoft's total investment portfolio actually stood at $62.7 billion.

Microsoft's investment strategy is as conservative as its business practices are aggressive. About $9.2 billion is invested in cable companies, content providers, and other tech-related businesses. The rest, a chunk of some $53.5 billion, is in what Microsoft calls its nonstrategic treasury portfolio—stocks and bonds in companies unrelated to Microsoft's core business, as well as government securities. About 70% of that goes to fixed-income investments, such as mortgage-backed securities, Treasury notes, and municipal bonds. Twenty percent is in cash and the final 10% in equities.

So how are Microsoft's investments doing? The company says its nonstrategic portfolio earned 7.5% last year and averaged annualized returns of 7.3% over the past three years. It did not disclose returns on the smaller strategic holdings. But overall, the company earned $1.6 billion—about 16% of net income—from investments in the just-ended fiscal year. Microsoft manages 75% of its investments. Professional money managers oversee the rest.

Not bad returns, but the question remains: Does Microsoft really need so much cash? Execs say it's an insurance policy against remaining litigation, including two biggies: the antitrust probe by the European Union and a private suit by rival Sun Microsystems Inc. And while the software giant doesn't talk about it, the cash offers a huge competitive advantage, letting Microsoft enter new markets and endure losses until it gains a foothold. Case in point: the Xbox game console and the MSN online business.

But $49 billion is far more than it needs. The maximum financial damage from the two cases comes to about $6.2 billion. EU regulators can fine antitrust violators up to 10% of the previous year's revenue, or $3.2 billion based on Microsoft's just-ended fiscal year. Sun has said damages could hit $1 billion, which can be trebled under federal law.

Hence analysts and investors figure the company could trim its cash holdings to $30 billion and have all the financial flexibility it needs. Many favor a major stock buyback, as well as an increased dividend. Both moves would transfer the money to shareholders by bolstering the stock price. With shares virtually flat this year compared with the Merrill Lynch 100 Tech index's 34% gain, Microsoft could turn this "problem" into opportunity.

Greene covers Microsoft from Seattle.

WHAT'S IN YOUR WALLET?

Microsoft's cash hoard is now so enormous that...

- It exceeds the **$45 billion annual gross output** of Romania
- The company could **mail every U.S. household a $471 check**—equal to the first-year $49 billion stimulus from the Bush tax cuts
- If you stretched all of the dollars end to end, they would **cover the distance of 10 round trips to the moon**
- Bill Gates could **buy up all the outstanding shares in eBay for $34.3 billion**—and have plenty of change to spare

Data: Census Bureau, World Bank, NASDAQ *BusinessWeek*

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RETAILING

SEARS: THE SILENT PARTNER WHO'S MAKING HIMSELF HEARD

Buybacks and asset sales show the influence of Ed Lampert

When CEO Alan J. Lacy announced the sale of Sears, Roebuck & Co.'s troubled credit-card unit to Citigroup on July 15, he argued that it would unlock the value of the division and allow Sears to focus on its retail business. Yet six months earlier, he declared that the credit business was an inseparable part of the whole.

Why the change of heart? Lacy declined to comment for this story, but many point to the influence of Edward S. Lampert, the low-profile investor who now has a 10% stake in Sears. "The sale completely fits his modus operandi," says a managing director at a hedge fund just down the street from Lampert's Greenwich (Conn.) office.

Lampert isn't talking, but a close look at the strategy he honed at other retailers suggests what he may be up to at Sears. By taking a position in a struggling company, then adopting an activist role, he has forced such underachievers as AutoNation Inc. and Kmart Corp. to focus on core operations, boost cash flow, and control costs. "Eddie is all about unlocking value," says Joseph Grabowski, an analyst at Strong Capital Management.

While Sears insists Lampert has no direct influence on operations, he is now the company's second-largest shareholder—and its most activist one. While Lampert dumped 1.5 million shares after Sears disclosed its intention to sell the credit unit, he retains a 10% stake that is worth $1.27 billion. And Sears certainly seems to be doing things Lampert is known to support. In the second quarter, for example, the retailer bought back $1 billion worth of shares. What's next? Some investors and analysts speculate that pushing Sears to sell the valuable real estate under its stores may be in the cards.

In the 15 years since he founded his ESL Investments Inc., Lampert, 41, has developed a reputation as a risk-taker with an eye for undervalued assets. That has paid off handsomely: Since 1989, his hedge fund has posted average returns of at least 25%. Kmart has been Lampert's most attention-grabbing play. He and affiliated investors bought most of the discounter's debt after it filed for bankruptcy in 2002. Then, after forcing Kmart to exit bankruptcy earlier than intended, Lampert converted his bonds into a controlling stake and became chairman of the board.

But Lampert's investments in the floundering AutoZone in 1997 and bled AutoNation three years later provide a closer parallel to Sears. A Zone has since focused on gener cash by cutting costs and squeezing pliers. AutoNation has focused o core dealership business and free cash by jettisoning noncore operat including a credit business. Both panies bought back large chunk stock. Improved profit performanc gether with the lower number of sh have sent the stocks soaring; since pert's investment, AutoNation's sto up 80%, while AutoZone's is up 20

Lacy, whom Sears says is in re contact with Lampert, appears to b lowing a similar strategy. Consider share buybacks. Analysts can't recal retailer repurchasin billion worth of shar a single quarter be What's more, the b has authorized ano $1 billion buyback. analysts expect Sea use much of the $4.5 lion in aftertax proc from the credit sal repurchase even r shares. Result: a stro stock—and a bi stake for Lampert.

Lacy also appear have shifted his cost ting goals since Lam came on the scene. sides going after h counts and store exp es, he has reduced ca expenditures, whic cut this year by from earlier project Much of that reduc stems from Lacy's p back on Sears' home-remodeling st the Great Indoors. A mer Sears official s Lampert made it c that he didn't think concept was a wise of funds.

Given Lampert's for unlocking value stands to reason, say investors, tha may look to the real estate holdi Sears owns 519 of its 872 mall sto Richard C. Moore, an analyst at Donald Investments Inc. and an ex on mall properties, thinks Sears' p erties could fetch $7.6 billion. Whet or not Lampert moves in that di tion, he has already made his mark America's third-largest retailer.

By Robert Berner in Chi

BUSY DEALMAKER

Hedge-fund honcho Lampert has built up big stakes in other retailers besides Sears

Data: Company reports

COMPANY	STOCK HOLDINGS	PLAY
KMART Discounter	58%	Installed a new CEO, became board chairman, and sped up Kmart's exit from bankruptcy to cut the chain's legal fees.
AUTOZONE Auto parts	With 25.2%, is the largest stakeholder	Named new CEO and took a board seat. The retailer has since cut costs and bought back shares, driving up the stock price.
AUTONATION Used cars	With 26%, is the largest stakeholder	Took two board seats. Company has cut costs, focused on core business, and bought back shares, boosting stock price.

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In Business This Week

EDITED BY ANNE NEWMAN

VIVENDI IS GOING... GOING...GOING

VIVENDI UNIVERSAL EXECS are scrambling to keep a muffed auction for their Hollywood studio, cable channels, and theme park on track. The MGM film studio, a leading bidder with a $11.5 billion cash offer, dropped out after Vivendi hiked its price to $14 billion. Other bidders have said they're frustrated by Vivendi's refusal to turn over some financial details. For now, the bidders still include Liberty Media, Viacom, General Electric's NBC unit, and a group headed by Vivendi Vice-Chairman Edgar Bronfman Jr. Cable giant Comcast has asked to look at the books but is unlikely to bid at the current levels, says a source close to the deal. To stoke interest, Vivendi Chairman Jean-Rene Fourtou met in mid-July with potential bidders. He has set an Aug. 15 deadline for new bids and hopes to complete a deal by September. But he may have to bring his price back down.

AOL: THE SEC OPENS ANOTHER FRONT

THE SEC IS OPENING ANOTHER avenue of inquiry in its yearlong probe of America Online's accounting practices. The online unit of AOL Time Warner received a request for information about its bulk-subscription program, as reported by *The Wall Street Journal*. Starting in 2001, AOL sold discounted memberships to strategic partners such as Sears Roebuck. The companies in turn sold the subscriptions for less than $10 each to employees. These members brought in lower revenues than full-price AOL subscribers paying $23.90 a month, but AOL disclosed few details of the program. It boosted growth, generating some 830,000 new members in 2001 and 2002. AOL and the SEC declined to comment.

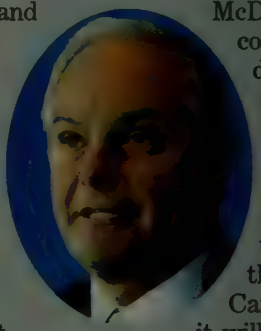
MORE BLACK INK AT XEROX

DECLARING XEROX' TURNaround complete, CEO Anne Mulcahy reported an 8% climb in second-quarter equipment sales on July 28. Gross margins remained 42%, and the company generated $682 million in cash, a 9% gain, despite weakness in the overall copier market. Although profits and sales both slipped 1%—net income hit $86 million on revenue of $3.92 billion—aggressive pricing helped increase share in key markets. Sales of higher-margin digital-office and production machines did particularly well. Just as critical for a company that faced possible bankruptcy only a few years ago: Cash on hand now sits at $2.3 billion, thanks in part to recent success raising money from bondholders, equity investors, and banks.

HEADLINER: JAMES CANTALUPO

HOTTER McNUMBERS

WHEN McDONALD'S LURED former Vice-Chairman James Cantalupo out of retirement last winter to become chairman and CEO, he vowed to reverse the fast-food chain's multiyear decline by going back to basics. Now, seven months into his tenure, McDonald's numbers are picking up.



Logging its best quarter since fall 2000, McDonald's said on July 29 that same-store sales at U.S. outlets rose 4.9%. The Oak Brook (Ill.) company didn't get the bump by selling more burgers and fries. Instead, Cantalupo credits two new hits: a line of premium salads and the M Griddle, new breakfast sandwiches.

Despite the new it McDonald's net in come slid again dropping 5%, $471 million, sales fell acr Europe and Asia. "We st have a long to go," concec the 59-year-old Cantalupo. He s it will be 2005 befo sales consistently rise b 3% to 5% and profits by to 7%. That's hardly the growth in the company' heyday. But at Mickey any positive number loo good compared with the past couple of years.

Michael A

AUDITING THE AUDITORS

LET THE SCRUTINY BEGIN. THE Public Company Accounting Oversight Board laid out its plans for examining auditors and their roles in corporate meltdowns. The PCAOB will review the Big Four this year, then annually inspect all firms that audit 100 or more public companies. PCAOB's predecessor hired audit firms to examine each other. Critics are challenging a provision giving accountants a year to fix problems before reports are made public. Two of the PCAOB's five members said they would urge boards to demand auditors turn over reports before the one-year wait is over.

CONSUMERS' BLUE PERIOD

CONSUMERS, LONG THE SPENDing leaders in this recovery, are getting a case of th blues. The Conference I reported its index of sumer confidence fell a seven points in July, to the lowest since war-sc March. The biggest fall in how householders about the economy's fu The board said consu spirits are deflated by rising level of unemploy and sentiment that a around in labor market ditions is not around the ner." Expectations are to remain weak until th bor market improves.

ET CETERA...

■ Cendant's Henry Silve exercised options on 2.8 lion shares and sold the s

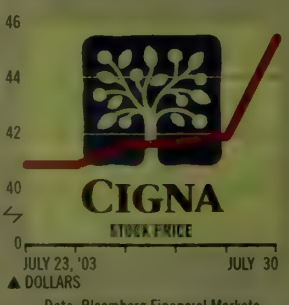
■ May Department Store sell 32 Lord & Taylor st and cut up to 3,700 jobs.

■ Clayton Homes inves O.K.'d a $1.7 billion take by Berkshire Hathaway.

CLOSING BELL

TRANSFUSION

Ailing CIGNA, hurt by falling premiums and soaring medical costs, is putting its pension unit up for sale for about $2 billion. With its stock off 48% for the year, investors welcomed prospects of a cash infusion for the nation's third-largest health insurer: CIGNA shares rose 8.5%, to 45.37, on the July 30 news.



Data: Bloomberg Financial Markets

ED BY RICHARD S. DUNHAM

URNING A TRADE FIGHT ITO A TAX WINDFALL FOR BUSINESS

er since the World Trade Organization ruled three years go that $4 billion in annual tax breaks for big U.S. ex- orters was illegal, Congress has been struggling to fix roblem. Now the squabble over export subsidies is g into a fight over much broader business tax cuts. That is pitting company against company and the tax-slash- louse against the more deficit-averse Senate. And it is threatening to become a hot potato in the 2004 Presi- al race.

e latest round was kicked off on July louse Ways & Means Committee Chair- Bill Thomas (R-Calif.), with the encour- ent of the White House, unveiled a plan would replace now-illegal export subsidies a huge package of other tax breaks. Al- h the banned subsidies are worth up to illion over 10 years, Thomas would cut ess taxes by $120 billion more than that. while many companies would enjoy a tax all, the exporters who benefited most the old subsidies, such as Boeing, Cater- and Microsoft, would end up worse off. has set off a huge battle within the busi- community.

mocratic strategists are thrilled. Presi- l hopefuls, already ripping Bush for run- up the deficit, are in a populist lather he prospect of new breaks for companies manufacture overseas. "The supporters of this bill seem interested in budget-busting tax cuts for multinational rations than in protecting American jobs," says Senator Edwards (D-N.C.).

act, the battle over which companies get the benefit will the debate over the WTO ruling itself. Thomas wants to the tax treatment between U.S. manufacturers and that produce overseas. But other key Republicans, s House Speaker J. Dennis Hastert (R-Ill.), insist on a tax system that benefits U.S. manufacturers such as Caterpillar, a major employer in his district.

And while national Democrats are on the rhetorical offensive, many congressional Dems quietly back tax cuts that help their local businesses. They prefer a bipartisan alternative offered by Representatives Philip M. Crane (R-Ill.) and Charles B. Rangel (D-N.Y.) that aids U.S. manufacturers.

In an effort to regain the political advantage, Thomas shifted gears. He still wants to reduce the tax advantages enjoyed by domestic producers. But he has added a fistful of other business breaks. Though they have little to do with trade, they are popular among many companies and their congressional representatives. Among them: lowering rates for small businesses and providing generous new benefits for the purchase of business equipment. The result is a corporate Christmas tree that has lobbyists salivating.

THOMAS: *Upping the deficit?*

Despite the add-ons, Thomas still has not rounded up enough votes to get his plan out of his own committee. And the bigger his tax cuts get, the more trouble he'll have in the Senate, which is reluctant to add to the deficit. Senate Finance Committee lawmakers are pulling together a bipartisan bill aimed at giving manufacturers a tax break for goods produced in the U.S. But they will insist that other cuts for business will have to be financed by closing corporate loopholes.

Lawmakers want to sort out the export tax mess this year. And in the end, both domestic manufacturers and those U.S. companies that produce overseas are likely to get some new tax benefits. But with deficits rising and businesses anxious for new tax breaks, Congress will first have to navigate the treacherous shoals of domestic politics. And that could turn out to be even harder than satisfying the WTO.

By Howard Gleckman, with Alexandra Starr

CAPITAL WRAPUP

SHOCRATS

ith polls showing President Bush ing the support of up to 15% of ocratic voters, his reelection cam- n is gearing up a Democrats-for- operation. The group will try to uit dissident Democratic officehold- into the Bush fold and increase the ident's support among blue-collar, olic, and suburban voters. A key er will be Brian Lunde, a hington consultant and former ocratic National Committee utive director.

SO WHAT IF HE LIED?

▶ If Bush is going to win over Democrats, he has some explaining to do to voters who think he stretched the truth in the runup to war against Iraq. Most Democrats consider him a serial exaggerator and don't think the invasion was worth it. Republicans believe just the opposite. But there's a growing swing bloc of voters who favor the war and don't care if Bush exaggerated. A July 22-24 Ipsos-Reid/Cook Political Report Poll says that so-what-if-he-lied hawks tend to be moderate Democrats, men, Southerners, and less educated voters. Yet when it comes to Bush's handling of the economy, 66% of them give him a thumbs down.

THE DEMS' ECON EDGE

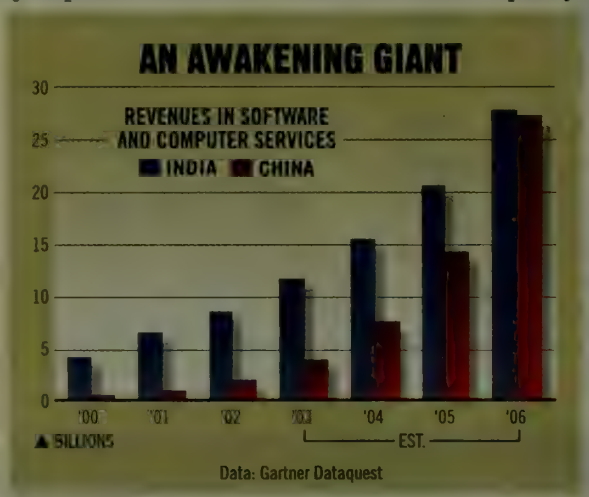
▶ Bush isn't the only Republican taking heat for the economy's slow snapback. A July 18-20 CNN/*USA Today*/Gallup Poll gave Hill Dems a double-digit edge in handling the economy, the deficit, and unemployment. In January, Republicans held a one-point advantage on economic stewardship. Now, Democrats lead, 53% to 36%.

CHINA

MOVE OVER, INDIA

China is rising fast as a services outsourcing hub

If you visit Tom Reilly's office in Guangzhou, you may have trouble hearing above all the construction noise. Workers at the Cap Gemini Ernst & Young facility in the southern Chinese city hammer away even as employees tap at their computer keyboards. Since it began in 2001 in a tiny, windowless room, the Cap Gemini center has grown to employ 120 people doing everything from entering sales data for a Hong Kong convenience-store chain to processing cargo information for a Norwegian shipping line. And Reilly expects the staff to reach 500 within 18 months. "It's the smell of progress," he says, sniffing the fumes of wet paint permeating the office.



That progress is starting to spread across China. After emerging as the world's hottest manufacturing hub, China is joining English-speaking countries such as India and the Philippines as a key destination for outsourced service jobs. Near Guangzhou's airport, a call center run by Hong Kong's PacificNet Inc. employs 2,000 Chinese manning the phones for telecom and insurance companies in Hong Kong, Taiwan, and China. PacificNet plans to have a staff of 5,000 by the end of next year. Accenture Ltd. has opened a software-development unit in the northern coastal city of Dalian that will soon boast 1,000 staff. And at its new center in Shanghai, BearingPoint Inc. (formerly KPMG Consulting) aims to quadruple its staff, to 600, by yearend 2004.

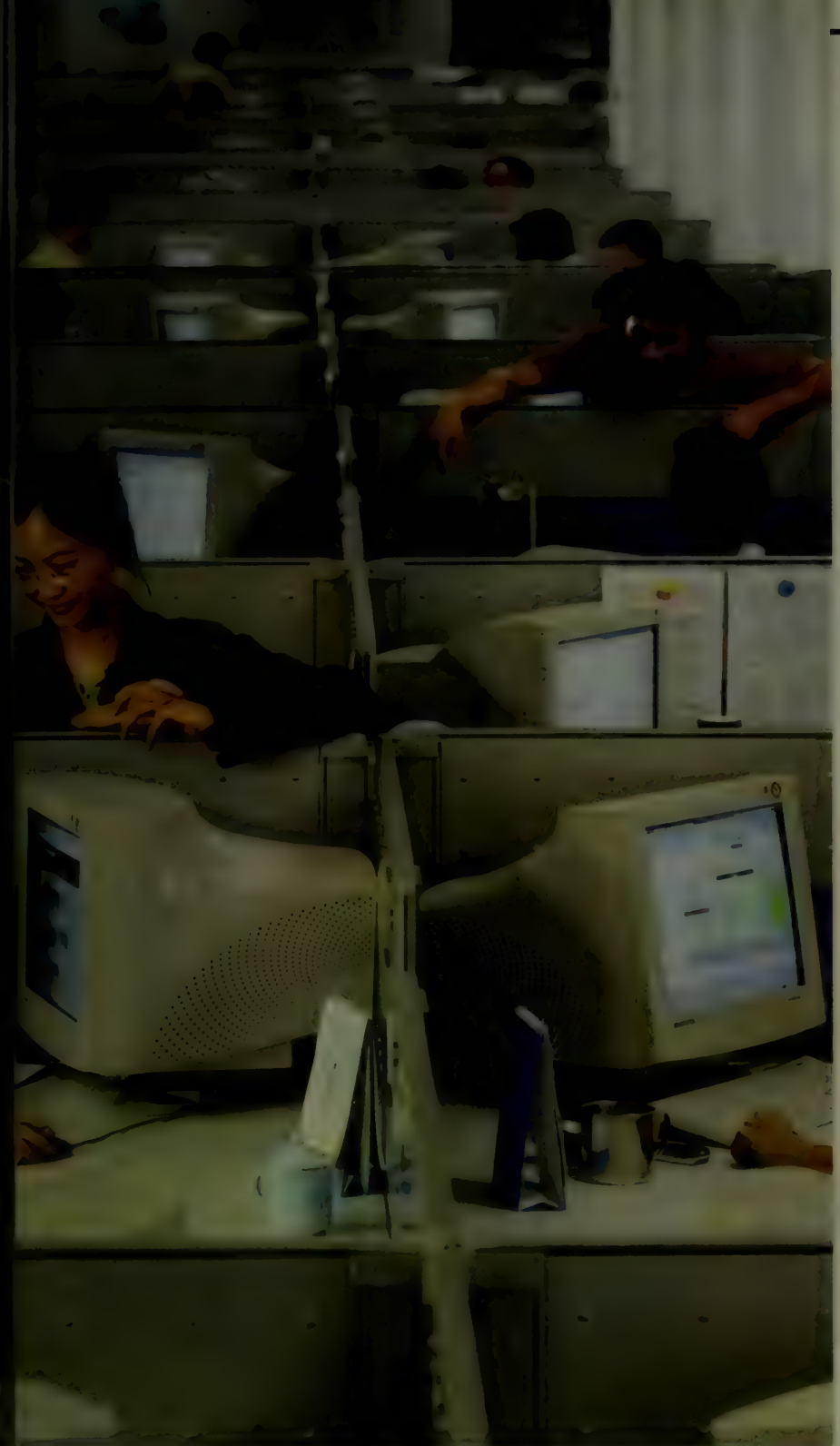
So far, China's role is largely focused on providing back-office support for financial service, telecom, software, and retail companies in neighboring Asian countries. Operators can easily talk to people in Hong Kong and Taiwan in their own languages. China also has plenty of Japanese and Korean speakers. But it is making inroads as an outsourcing base for English-speaking nations, a business dominated by India, because of the influx of Western multinationals who now are bringing back-office work to China. ConnectITChina, a Shanghai consultancy, estimates China's software outsourcing revenue will more than double, to $5 billion, by 2005. Gartner Inc. predicts that by 2007, China will pull in $27 billion for IT services, including call centers and back-office work, matching India.

China's ascent could inflame an already heated debate in the U.S. about companies sending work abroad. With the U.S. economy still struggling and the jobless rate at 6.4%, lawmakers in several states want to make it harder for governments to contract work to low-wage countries. India is the center of attention. But China, which many Americans view as a political and economic rival, is likely to be a bigger lightning rod for outsourcing foes.

The economic forces driving work to China are powerful, though. There is huge demand inside China for skilled service workers to meet the needs of both the country's own booming economy and of the thousands of foreign companies that have set up manufacturing bases on the mainland. Many companies in Greater China are, for instance, turning to outside providers for information technology needs rather than doing the work in-house. "There's massive need for data entry from banks, insurance companies, and hospitals," says PacificNet CEO Tony C.W. Tong. Operators at Tong's call center start at salaries of $150 per month; in Hong Kong they average $1,300. PacificNet serves Chinese cellular carriers and is mulling a Dalian office for Japanese clients.

Chinese officials aim to give this burgeoning industry a push, by forging partnerships with multinationals to train information technology engineers. For example, IBM signed deals to train 100,000 softw specialists in various Chinese cities three years. Indian computer-trair companies are teaching 20,000 student more than 100 centers across China. G ner figures China needs 4 million mor professionals to meet future demand.

Foreign IT services companies are using China as a base for winn business in Asia. One reason Accent picked Dalian for its rapidly expand software-development office, wh opened in mid-March, is that the cit a major hub for Japanese and Kor multinationals. When it comes to wo



LOW COST: *An E5 center in Shenzhen*

those languages, says Accenture manager Gong Li, "it's much easier our people in China" than for in India or the Philippines.

ina's low-cost talent is another Although India is a powerhouse in end IT services, latecomers these must pay higher wages for experienced engineers. That's one reason ngPoint chose Shanghai for its new software-development center, says the company's Greater China President, Bryan Huang. BearingPoint pays $500 a month for engineers in Shanghai. In India, he says, the pay would be $700, and $4,000 in the U.S. "Where can we sustain our cost advantage for the next 40 years?" Huang asks. "We're convinced that China is the only place."

American manufacturing companies are discovering that cost advantage, too. Sweetheart Cup Co., an Owings Mills (Md.) maker of plastic plates, cups, and utensils for customers such as McDonald's and Wendy's International, hired consultancy E5 Systems of Waltham, Mass., to develop a system to track production processes at its 14 North American factories. E5 is doing the job in Shenzhen, where it has a joint venture. Sweetheart figures it saves 40% by sourcing in China rather than India. In a business where pennies matter, "cost is a consideration in everything we do," says John McGregor, Sweetheart's chief information officer.

Several big Indian IT-services companies are determined to tap China for their own advantage. In fact, Gartner predicts Indian firms will eventually control 40% of China's IT services exports. Satyam Computer Services Ltd., India's fourth-biggest supplier, set up a 27-person development center in Shanghai last year with plans to expand. Satyam Asia-Pacific Chief Virender Aggarwal says his sales team is telling him that China presents more opportunity than any other country, mainly from multinationals that need reliable software support for their expanding mainland businesses. India's Tata Consultancy Services has a 100-person software center in Hangzhou, near Shanghai. Midsize Indian players are moving to China, too. In February, iGATE Global Solutions, a $90 million Bangalore software provider, set up in the eastern city of Wuxi. So did $91 million MphasiS Group, which in October bought a 50-employee Chinese software developer in Shanghai. So far, 14 Indian companies have set up shop in China, says India's National Association of Software & Service Companies.

No big Chinese rivals for the multinational outsourcing firms have yet emerged—although that may soon change. Piracy fears, relatively poor English, and a lack of high-level international quality certification have held Chinese upstarts back. But with training and experience, such obstacles are surmountable. And expertise in written and spoken Asian languages will remain an edge. By honing skills in burgeoning markets close to home, China's IT outsourcing industry is sure to get up to speed fast.

By Bruce Einhorn in Guangzhou, with Manjeet Kripalani in Bombay

China's growing prominence in outsourcing is likely to inflame the debate in the U.S. over sending jobs abroad

SWEDEN

TO EURO OR NOT TO EURO

Its coming vote on adopting the currency has Sweden on edge

In high summer, Stockholm shakes free of its usual gloom. During the daytime, the bright sun picks out the Gothic spires and pastel facades around the winding shores of the harbor. In the evenings, the bluish light that lasts until midnight confers a magical quality on the Swedish capital. Children swim off rocky islands, and the music of brass bands playing on antique steamboats floats across the water.

The serenity is beguiling but deceptive. Beneath the surface, a battle is brewing that could turn nasty as quickly as the first frosts change the birch leaves from green to yellow. On Sept. 14, Sweden will vote on adopting the European single currency. When voters enter the booth, they'll face a nail-biting choice about what kind of country they want: a go-it-alone welfare state that relishes its place on Europe's periphery, or a full-fledged member of the Brussels-driven experiment to create a unified European state.

It's not just the Swedes who are wondering which way they'll vote. The fallout could extend well beyond the Nordic zone. A resounding thumbs-down could be interpreted as a vote of no confidence in the European Central Bank, already under fire for being tardy in coming to the rescue of the limping German economy. British Prime Minister Tony Blair's hopes of shepherding his country into the European Monetary Union (EMU) might also be dashed if the anti-euro contingent in Britain gathers fresh courage from a Swedish rejection.

The "yes" camp argues that Sweden needs to be part of the euro zone if it wants to be a player in Europe. The immediate rewards: more investment and trade. What's more, a Sweden bound by the euro's budgetary constraints would be less likely to backslide into higher taxes and inflation. The "no" contingent says that the free-floating krona has served Sweden well: Once in the euro zone, Sweden will no longer have a currency that can adjust quickly to boost the fortunes of exporters such as Volvo and Svenska Cellulosa, the forestry-products giant.

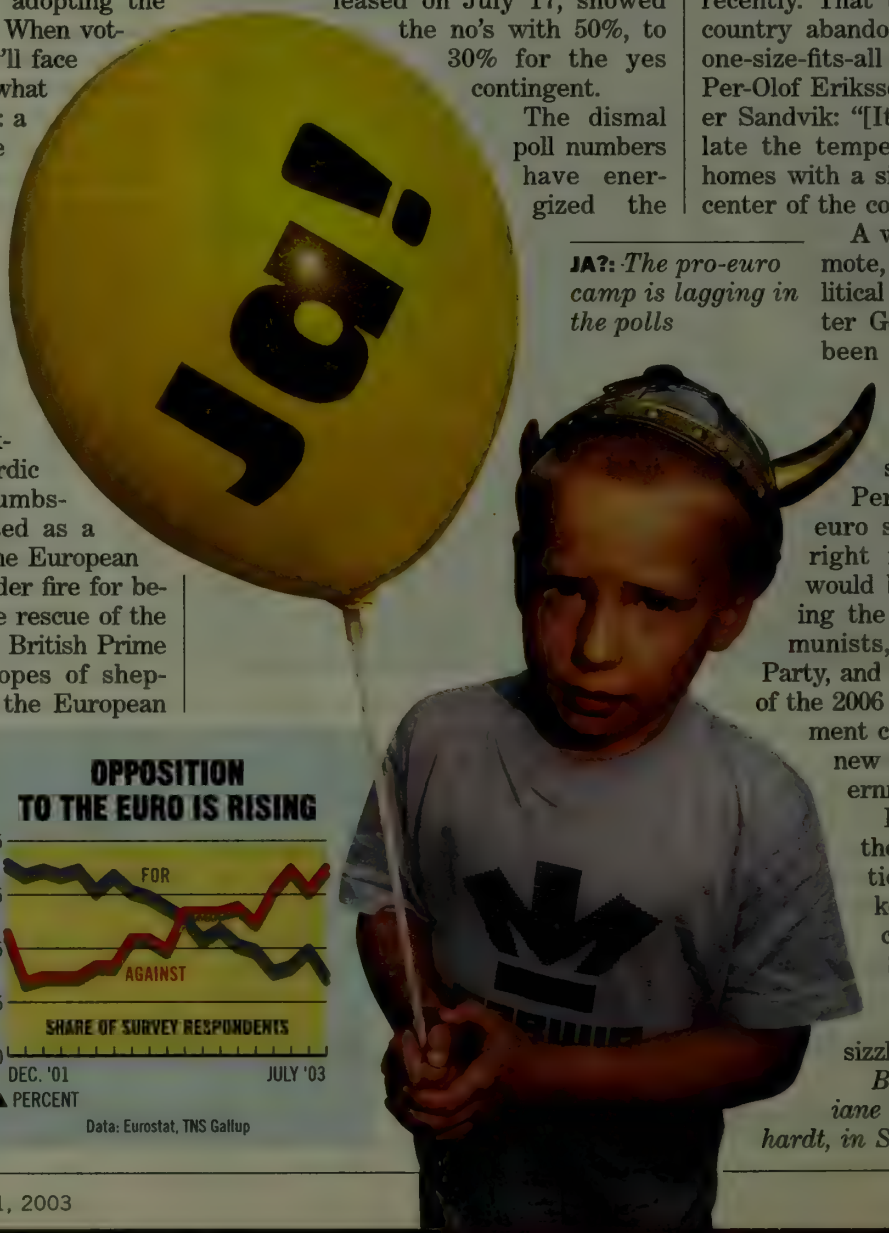
So, is it *ja* or *nej*? Just a year ago, the yes side was well ahead. But a sluggish euro zone, along with a slowdown at home, has helped shift sentiment. The most recent poll by TNS Gallup, released on July 17, showed the no's with 50%, to 30% for the yes contingent. The dismal poll numbers have energized the pro-euro camp, primarily compr politicians and business leaders. T ster their case, they've conjured up doomsday scenarios. A no vote, warn, will relegate Sweden to ma economic and political status. "We' the outskirts of Europe, and we to work every day to persuade int tional companies to invest in our p the world," says Jacob Wallenberg, man of SEB, a Stockholm-based "Being on the outside" would mak job harder, he says. Carl-Henric berg, the new CEO of phone giant son, warns that a no vote might Swedish corporations to scale bac erations in their home country. He it will be "very dangerous" to hav jor costs such as R&D billed in a volatile currency, while sales are la to dollar and euro customers.

Not all Swedish executives are europhiles. Some ask: Why not and see how the euro works for o before taking the plunge? After Sweden has outperformed the euro recently. That trend could end i country abandoned itself to the one-size-fits-all monetary policy, Per-Olof Eriksson, ex-CEO of steel er Sandvik: "[It's] like trying to r late the temperature of all Swe homes with a single thermostat in center of the country."

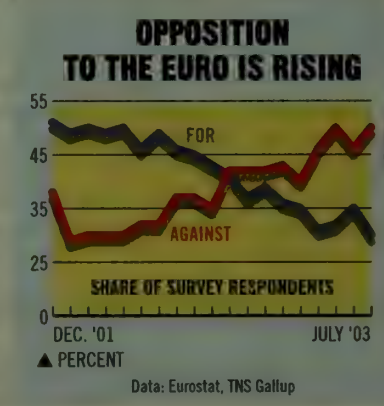
A worrying, though stil mote, prospect is that o litical upheaval. Prime M ter Goran Persson, who been in power since 1 may come under p sure to resign if th camp wins by a l slide. Social Demo Persson has backed euro strongly. Also, an right rejection of the would bolster the forces l ing the no campaign—ex-c munists, the agrarian Ce Party, and the Greens—in adva of the 2006 elections. That dev ment could set the stage f new era of uncontrolled ernment spending.

For Swedish busin the euro's biggest att tion is that it will h keep free-spending p cians in line. But it's Swedes, not Swe Inc., who will de the issue. It could b sizzling September.

By Stanley Reed and iane Sains, with Andy R hardt, in Stockholm



JA?: *The pro-euro camp is lagging in the polls*



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TED BY ROSE BRADY

HINA: A WARMER WIND BLOWING TOWARD THE WEST

ost China watchers thought it would take years before the country's new leader, Hu Jintao, came out from under the shadow of former President Jiang in, especially when it came to international affairs. Yet than five months into his presidency, Hu is bucking exations by quickly defining a more pragmatic foreign polourse—delighting Western policymakers.

here Beijing once reacted with strong words of conation to anything that suggested a West bent on hegey, Hu's government has largely refrained strong criticism of the U.S. war on Iraq. has been warming relations with traditionvals such as India and reacting relatively ly to Japan's moves to strengthen the role s military. "It's extraordinary if you con- [China's reactions in] the past," says Shi ong, a professor of international relations eople's University in Beijing. Perhaps most rtant to stability in the neighborhood, Hu been making a surprisingly assertive push ase tensions on the Korean peninsula.

is international initiatives come in the wake s first big challenge—the SARS outbreak this spring. Hu's skillful handling of that crisis ed him to emerge from under Jiang's wing assert himself on the domestic scene faster anticipated. Now, Hu appears to be trying ut his own mark on foreign policy, too. He decided that China's economic goals necessitate an ever ter emphasis on building more stable relations with its hbors. Policy is being "driven by their desire to minimize ign policy problems so they can focus on domestic eco- ic developments," says Kenneth Lieberthal, a China expert e University of Michigan and former Clinton Administra- official. "They're not being very ideological about it."

hina's aggressive role in pushing for a settlement to the th Korean nuclear standoff clearly reflects this pragmatism. Putting aside a decades-old tradition of siding with communist ally Pyongyang, Hu has presided over an unprecedented blitz of activity intended to bring the U.S. and North Korea to the bargaining table in Beijing in September. Vice-Foreign Minister Dai Bingguo has recently visited Moscow, Pyongyang, and Washington. Hu himself took the unusual step of writing a letter to North Korea's Kim Jong Il. "It is crucial to [China's] national interest to keep stability on the Korean peninsula," says Wang Yizhou, deputy director of the Institute of World Economics & Politics at the Chinese Academy of Social Sciences.

HU: *Minimizing conflict*

Of course, Hu could yet run into diplomatic troubles. His initiative on North Korea could founder, slowing his overall political momentum. Or new tensions could arise with Taiwan or Hong Kong that could lead to international repercussions. Another wave of protests could take place soon in Hong Kong as debate reopens on a controversial antisubversion law. With Taiwan, Hu's big challenge will be dealing with the likely prospect of provocative statements in the runup to the island's presidential election early next year. Meanwhile, frictions could arise with the U.S. over trade issues.

As Hu continues to strengthen his grip on China's foreign policy, one key test will be managing Jiang Zemin. The former President remains chairman of the powerful Central Military Commission and was looking forward to a continued, prominent role in foreign policy. But his younger successor is showing every sign of charting his own course at home and abroad.

By Dexter Roberts in Beijing

BusinessWeek online

For an interview with China expert Kenneth Lieberthal, go to www.businessweek.com/magazine/extra.htm

GLOBAL WRAPUP

IGENTINA'S SURPRISE

Argentine President Néstor Kirchr's decision on July 25 to strip red military officers of their longanding immunity from extradition for man rights abuses during the 1976-83 dictatorship led to the arrest of least 40 people. But Kirchner is not ly helping the country confront its irty war." The move could prove a asterstroke in consolidating the new ronist President's political base.

Kirchner has surprised the skeptics. ey shrugged when he pledged, upon taking office on May 25, to stamp out corruption and put an end to official impunity—just as his predecessors have vowed. But Kirchner has distanced himself from the pack by doggedly pursuing some of the country's most mistrusted institutions—the Supreme Court, police, and even labor unions, traditionally a staunch Peronist ally. In going after the military responsible for the disappearance of 30,000 suspected leftists in the last dictatorship, Kirchner, who was jailed briefly for activism in the 1970s, has homed in on the most powerful symbol of the old model he aims to break.

Argentines are applauding. Kirchner's popularity rating has soared to almost 80%—an amazing jump given that he was elected by default with 23% of the vote after the top vote-getter, Carlos Menem, withdrew from a scheduled second round. Kirchner may need that political capital if he has to agree to tough, controversial demands from the International Monetary Fund to meet a September deadline for a new loan accord and roll over $6 billion in multilateral debt due by yearend.

By Joshua Goodman in Buenos Aires

EXECUTIVE SUITE

IS THIS BANKER TOO BRAZEN?

Commerce Bancorp's Vernon Hill has led a rapid expansion, but his style is raising a few eyebrows

If there's one thing to know about how Vernon W. Hill II, the founder, chairman, and president of fast-growing Commerce Bancorp Inc., does business, it's this: He gives his managers $5,000 if they shut down a rival branch. It also can't hurt to know that he calls his competitors' practices "stupid" and their brands "rotten." Or that even the mere mention of another bank often elicits a response. When a woman at a July meeting for new Commerce executives tells Hill that she used to work at First Union Corp., he replies with a snicker: "Or F.U., as we call it around here."

It pretty much goes without saying that Hill's confrontational manner does not exactly endear him to other bankers. And that's putting it mildly. "Vernon likes rubbing his competitors' noses in Commerce's success," says Thomas K. Brown, chief executive officer of Second Curve Capital, a hedge fund that holds Commerce shares. Hill puts it this way: "I don't get invited to a lot of banking conventions."

What makes the 57-year-old Hill so sure of himself is that he has actually built a bank with $20 billion in deposits from scratch. He was only 27 when he opened the first branch in New Jersey in 1973. After working for years to make a name for himself there, as well as in Pennsylvania and Delaware, Hill has deemed the bank ready to venture into the crowded New York market. In the past two years, Commerce has opened 27 branches in New York City and Long Island, nearly half in Manhattan. In all, the bank now has 245 branches, 95 of which didn't exist in 1999 and most of which were financed through a debt offering and the company's own earnings. By the end of 2007, Hill expects to move north to Boston or south to Washington, creating a network of more than 500 branches with $50 billion in assets. Commerce's recent rapid growth has so far had the desired effect: Between 1998 and 2002, the bank's net income has grown an average of 31% annually to $145 million. This year, the bank's deposits increased 44% in the second quarter, compared with last year. And since the beginning of 1998, Commerce's stock has risen 130%.

What makes Hill so disdainful of other bankers is what he says is their stubborn belief in the status quo. For the past decade, Hill has willfully ignored the conventions of the banking world. He throws block parties when he opens a new branch and hosts lunchtime or weekend concerts at many of them. He keeps branches open until 8 p.m. during the week and has Saturday and Sunday hours, too; every branch has a coin-counting machine that anybody can use. Drive-through tellers hand out dog biscuits to customers who travel with their pooches. In short, Hill has brought some retail smarts to retail banking.

No doubt about it, Hill relishes his role as the banking industry's cheekiest maverick. He's less thrilled about his reputation as one of the most controversial banking executives around. That's because the rep is for all the wrong reasons. While no one argues the bank isn't sound, analysts and critics are starting to ask questions about the risks of Commerce's aggressive expansion, about some personal business deals between Hill's family and the bank, and about Commerce's political influence in its home state.

Hill was just a few years out of the University of Pennsylvania's Wharton School, where he received a B.A. in economics, when he persuaded a group of local New Jersey businesspeople to put up $1.5 million to start Commerce. Hill, who grew up in Virginia, had helped put himself through college working in a New Jersey bank. But he was absolutely uninterested in signing on with one of the giants. "It was obvious I wasn't going to get rich working for a bank," he says. And that has always seemed to be the point. When Hill started Commerce, he already had a real estate site location business going; in the mid-198 decided to invest in dozens of Bu Kings. Today, he still has stakes in those enterprises, and he and his fa own about 5% of Commerce's sha which are worth some $140 million. cording to the company's 2002 prox

Despite the bank's rapid expans Hill still controls almost every facet o operations. Commerce opens some new branches a year, and Hill perso approves each location. When the b reviews a loan of more than $7.5 mi (and it considers about five a week) Hill who looks it over. He behaves every issue is urgent: His e-mails written IN ALL CAPS. For Hill, Comm is not just a business, it's a way of "You are all cult members," he tells executives. "And if you can't buy in, isn't the place for you."

But for all his talk, and for that r ter all his accomplishments, analysts critics are asking if Commerce is hea

VERNON W. HILL II

BORN Aug. 18, 1945, San Francisco.

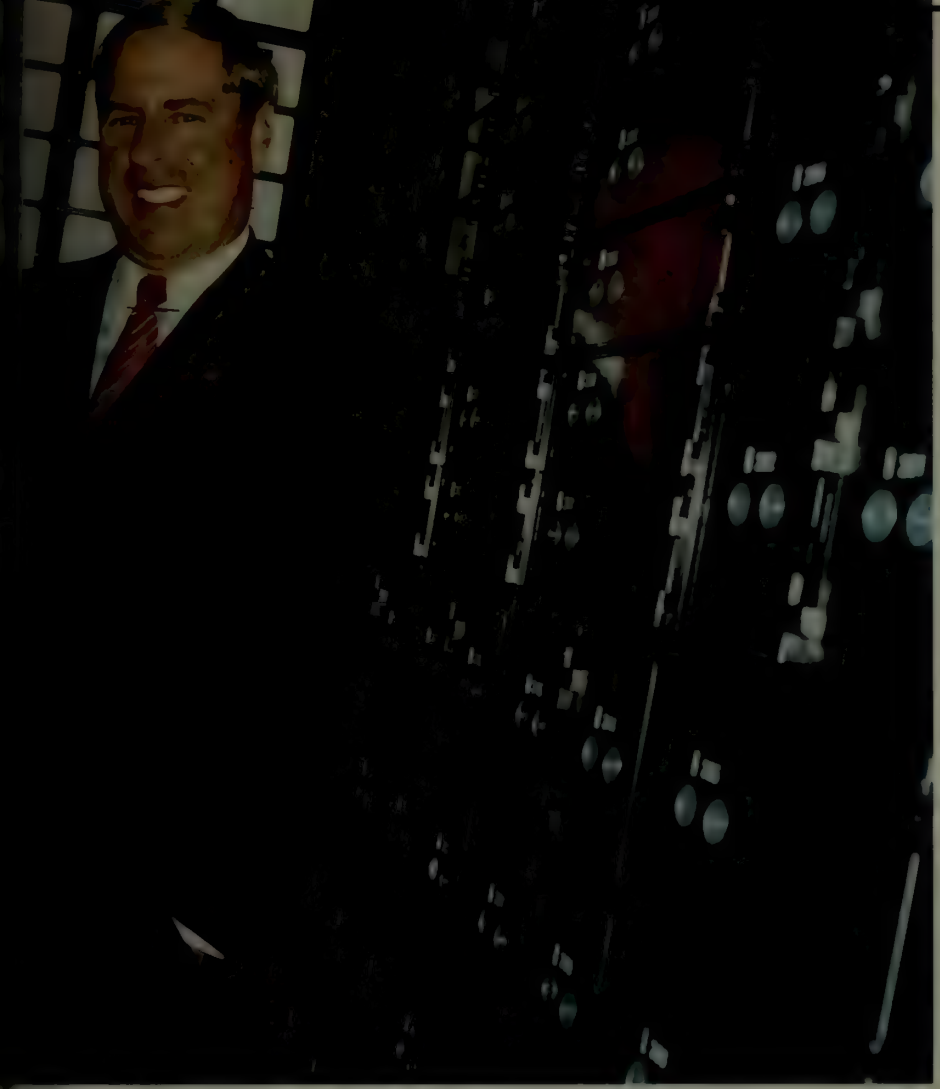
EDUCATION B.A., economics, University of Pennsylvania's Wharton School, 1967.

CURRENT POSITION Runs $20 billion Commerce Bancorp, which he founded at age 27.

CREDO "We deliver [service] the way the great retailers deliver, not the way the stupid banks deliver."

PUBLICITY STUNT Got golfing buddy Donald Trump to make a $5 million deposit at th bank's first NYC branch.

FAMILY Married to his second wife, Shirley, fo 30 years; four kids fro both marriages.



ll brushes aside criticism of Commerce's large holdings of mortgage-cked paper and his family's dealings with the bank he founded

IRMAN AND PRESIDENT HILL AT A COMMERCE BRANCH IN CHERRY HILL, N.J.

rouble. Among the chief concerns is bank's investment portfolio, which makes up more than half of its ts. Because Commerce's deposits grown more quickly than it could the money out, it has invested the , mostly in mortgage-backed securi- If interest rates rise, which is high- ossible in the next year or so, the e of Commerce's portfolio would fall. t in turn could erode the bank's cap- levels and its ability to continue ex- ding, warns Keefe, Bruyette & Woods analyst Thomas J. Monaco.

t the same time, there are concerns ut Hill's strategy of growth at any . Commerce's so-called efficiency ratio, ch measures how much a bank spends enerate $1 in revenue, is 70.7%, ac- ding to Robert J. Lacoursiere, an an- t at Lehman Brothers Inc. The in- try average is far leaner, at about . And Commerce's return on assets is than 1%, well below that of other ks. "His growth is not as profitable as of his peers," says Lacoursiere. As such concerns have spread, the stock has lost about 8% of its value this year.

Hill gives such critics about a minute of his time. He acknowledges the bank's return on assets is lower than its competitors', but argues that return on equity is a better measure of performance—and there, Lacoursiere says, Commerce is in line with the rest of the industry. As for the large securities portfolio, Hill says a rise in interest rates would in no way compromise the bank's continued growth. And he believes that it's better to invest the money flowing in from deposits in securities than rush to make loans that could go bad. "We aren't going to compromise credit quality," he says.

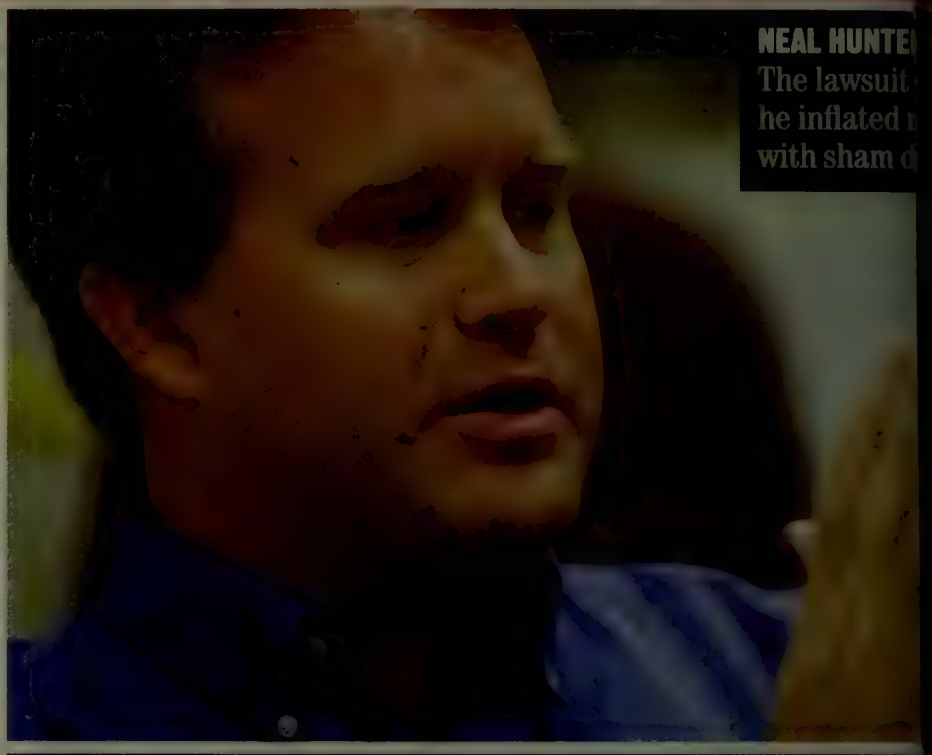
Commerce's potential business pitfalls aren't the only issues dogging Hill. The cozy ties among him, the company, and its board are also coming under scrutiny. The bank has built 17 New Jersey branches on land it leases from Hill's family trust or limited partnerships in which he has an interest, paying $1.1 million in rent in 2002. Commerce also paid $451,000 last year to use facilities at Galloway National Golf Club, a private golf course outside Atlantic City in which Hill is a principal investor. In addition, a design firm owned by Hill's wife, Shirley, received $8.1 million last year for architectural design and project management services provided to the bank. And one son, Vernon Hill III, is a real estate broker whose firm does business with Commerce. Hill says that relationship doesn't have to be disclosed because his son is not paid by the bank. In fact, excluding Hill himself, 8 of the board's 11 directors are either insiders or individuals who now have or have had some sort of business relationship (either directly or through their firms) with Commerce or its top executives. "For public companies these days, these types of relationships raise eyebrows," says Charles M. Elson, director of the Weinberg Center for Corporate Governance at the University of Delaware.

Critics also contend that Commerce's political ties and generous contributions in New Jersey have helped the bank nab lucrative municipal underwriting business. Hill says all Commerce's political activities have been proper. But he announced earlier this year that the bank would halt all political action committee contributions in New Jersey until the rules become clearer.

Hill also says that last summer he decided he would no longer engage in any new real estate deals with the bank. And Commerce has now cut back on the business it does with his wife, but won't stop altogether because "she does an unbelievable job." The bank will continue to use the golf course because it's a "great" place to entertain guests. As for the board, Hill says, "they have produced unbelievable shareholder returns." He argues that a majority of the directors are independent under New York Stock Exchange rules, but says the board will "evolve." Jack R. Bershad, a director, says they are discussing bringing new people in.

In the meantime, Hill is enjoying his success. Last fall, he and his wife moved into a nearly 46,000-square-foot mansion they built near Commerce's headquarters in Cherry Hill, N.J. The estate, called Villa Collina, boasts some eight reflecting pools on the grounds. And, maybe best of all, it gives Hill something else to rub his competitors' noses in.

By Amy Barrett in Cherry Hill, N.J.



NEAL HUNTE
The lawsuit
he inflated
with sham

FAMILIES

BLOOD

In years past, Christmas gatherings for the Hunter family were joyful occasions. The three Hunter boys would play football in their yard in Boone, N.C. Their mother, Annabel, would make paper angels for her sons, who would hang them on the Christmas tree. For a while, they had much to celebrate. In 1987, Eric, the middle son, and his younger brother, Neal, founded Cree Inc., a company that makes light-emitting diodes, or LEDs, which are semiconductor devices used to light mobile phones, car dashboards, and other products. Over the next decade, Cree grew to become one of the most successful startups ever to come out of the state's famous Research Triangle Park.

But at Christmas in 1999, the good cheer turned bitter. Eric, who had given up his chief executive post to Neal in 1994, had thought for several months that his younger brother was mismanaging the company. During the holidays, Eric voiced his concerns about the alleged misconduct, according to an affidavit from Eric's wife. The tension boiled over one night after dinner at an aunt's house, when the brothers and their cousins were outside having a snowball fight. Eric pelted Neal, and Neal responded, Eric says, by slamming him to the ground, cutting his leg. "There was blood all over the place," says Eric. Neal declined to comment on the incident.

Since then, the fight has escalated into a high tech family feud. Eric, now 44, has unleashed a blistering attack against his 41-year-old brother, culminating with a lawsuit filed in June that seeks $3.2 billion in damages from Neal and Cree. In the suit, Eric accuses Neal of artificially inflating Cree's revenues by concocting sham transactions with Charles & Colvard Ltd. (C&C), a gem manufacturer that Eric co-founded in 1995 with his older brother, Jeff. Eric also alleges that Neal filed false financial statements with the Securities & Exchange Commission and made millions selling Cree stock based on nonpublic information. And Eric contends that since he started publicly questioning Neal's activities, he has been followed by strangers and threatened with physical harm. He currently is living in Switzerland—to protect his family, he says.

Cree and Neal Hunter say these charges are absurd. The company maintains all its dealings with C&C were proper, that its financial statements are sound, and that Neal's stock sales violated no laws. Cree's current c
Charles M. Swoboda, adds that
has never authorized anyone to fo
Eric or his wife, Jocelyn. Cree law
have asked for Eric's case to be
missed. "The airing of personal fa
grievances in the guise of securi
fraud and harassment claims again
public company is an improper us
the judicial system," Cree said i
court filing. C&C lawyer Bill Raper s

WAR OF THE HUNTERS

Eric Hunter is suing his brother Neal and Cree Inc., a company he helped found, for more than $3 billion. The main charges:

ALLEGATION Eric says Cree inked several deals with Charles & Colvard, which buys silicon carbide crystals from Cree, that artificially inflated Cree's financial results.

RESPONSE Cree says the deals were legitimate. Plus, all the deals were disclosed in financial filings.

ALLEGATION Eric says that his brother Neal improperly sold Cree securities several months before a $76.5 million write-off in May, 2002, that hurt Cree's stock.

RESPONSE Neal says the stock sales were proper and simply to diversify his investment portfolio.

ALLEGATION Eric says Neal and others associated with Cree have harassed and threatened him and his wife.

RESPONSE Cree says it has not instructed anyone to harass or threaten Eric or anyone in his family.

EUD

A bitter battle between two brothers is hurting Cree, a promising LED chipmaker

e allegations are somewhat out-ish, and we intend to vigorously de- [against] them."

ow vigorous the defense will be is ming apparent. Lawyers for Cree e responded to the legal assault by cking Eric Hunter's mental health. ine affidavits, including statements n his mother and brothers, Eric is cribed as a problem drinker who s prescription drugs to control his iety. The filings, copies of which e obtained by *BusinessWeek*, include eral descriptions of unusual state-nts by Eric. They include assertions Eric said he worked for the Central lligence Agency, that his family was ed with the John F. Kennedy assas-tion, and that Cree was involved h someone who threatened to kill ner Vice-President Al Gore. "I have ched Eric's mental health decline r the past decade and particularly r the past three or four years," said mother in her June affidavit.

Eric Hunter says he is not mentally ill. He denies making any of the bizarre statements attributed to him and says he never has been diagnosed with "any psychosis." He admits to taking Quazepam to help with anxiety and Ambien for insomnia. And he says he does not have a problem with alcohol. "Have I been depressed at times and drunk a six-pack of beer? Sure," said Eric, during an interview from Interlaken, Switzerland. "Do I have a drinking problem? No." Dr. John Hand, a professor at the University of North Carolina School of Business, who has gotten to know Eric over the last four years, made an affidavit in which he said he had never seen Eric exhibit "any signs of mental instability," and a private investigator hired by Eric's attorneys testified that "it became very clear to me that the Hunters were indeed being followed."

The saga of Cree and the Hunter brothers is a cautionary tale of how family feuds can dim a company's promise. Since the lawsuit was filed, Cree's stock has tumbled by 39%, to around $14 a share, slicing $700 million off its market capitalization. Short-sellers are swarming: With 33% of its shares sold short, Cree has the second-largest short-interest ratio on the NASDAQ. At least 15 class actions have been filed against Cree, echoing many of the charges outlined in Eric's complaints. On July 10, Cree disclosed in a financial filing that the SEC had opened an informal investigation into the company. And on July 29, the company reported disappointing earnings for the quarter ended June 30.

Strip away the internecine fighting, however, and Cree could have a bright future. The LED market is soaring, and Cree is one of the leading players, along with Nichia, Toyoda Gosei, and Osram. Because LEDs generally use less power and last longer, many scientists believe that as costs come down over the next 10 to 20 years they could replace Thomas Edison's lightbulb and reinvent the $40 billion illumination market. For the fiscal year ending June 30, 2004. Friedman Billings & Ramsey & Co. expects Cree to boost sales 21%, to $278 million, and profits 23%, to $44 million. "We don't think it's unrealistic to go after $1 billion in sales within five years," says Cree CEO Swoboda.

So why is Eric Hunter attacking the company he founded—as well as his own flesh and blood? Eric says he first became upset with his brother in the early 1990s, when he was still Cree's chief executive. Among other things, Eric was distressed by Neal's relationship with a Charlotte (N.C.) stockbroker named Burt Davis. Eric says in his lawsuit that Davis artificially pumped up Cree's stock by promoting it to institutional investors—a charge Davis denies. Eric resigned as Cree's CEO in 1994 because "I didn't want to deal with all the crap," he says. In recent years, Eric has become increasingly agitated by actions that he thinks are unethical and potentially illegal. "We're just out for justice," he says.

The Hunters were not always at war. They started out as a tight-knit, North Carolina clan. Their father was a doctor, and Mom was a homemaker. But their happy childhood was shattered when their father committed suicide in 1967. "They found him in a graveyard where he cut his wrists," says Eric. To this day, Eric says he does not know why his father killed himself.

The boys remained close. Eric and Neal swam on Watauga High School's relay team together. All three boys attended North Carolina State University

in Raleigh in the early 1980s. And when Eric came up with the idea of starting a company based on a new semiconductor technology that he worked with at N.C. State while getting his masters in materials science, he turned to Neal. "We met at a biscuit place in Boone and decided to do the company," recalls Eric. They called it Cree after their old man, Charles Cree Hunter.

Eric ran the company for seven years and took it public in 1993, but he handed the reins to brother Neal in August, 1994. Neal, say several investors and former Cree executives, proved to be a better manager than Eric had been. Over the next few years, sales and profits soared. "Cree would not have been a tenth as successful without Neal Hunter," says Bob Lynch, who served as Cree's vice-president for operations from 1994 to 2000.

Eric took advantage of his decreased responsibilities to start a new business. In June, 1995, he and Jeff founded C3, now known as Charles & Colvard, to create gems out of silicon carbide crystals. They named the company after their father and grandfather, Fred Neal Colvard, who helped raise the Hunter boys after their dad's suicide. Jeff was chairman and president, while Eric was a consultant and the biggest shareholder, with 18% of its stock. Neal was granted 70,000 shares of stock but had no operational role in C&C.

SWOBODA: Aiming for sales of $1 billion

Several years later, Cree and C&C began to have such close dealings that they came in for criticism from Eric. And some analysts and accounting experts say they used unusually aggressive accounting. Off Wall Street, an investment research firm, published a report in December, 1999, calling attention to Cree's dependence on sales to C&C. For the fiscal year ending June 30, 1999, Off Wall Street concluded that sales of silicon carbide crystals to C&C made up 24% of Cree sales and 75% of its operating income. Off Wall Street wrote that Cree's growing sales to C&C coincided with C&C's ballooning inventory. In the quarter ended Sept. 30, 1999, C&C had 977 days of inventory, up from 341 the quarter before. "It is difficult to think that the fact that inventory is rising is anything other than an accommodation to Cree," wrote Off Wall Street. In its 10-K filing for 2001, C&C said the excess inventory was in anticipation of "substantially gre sales growth than we have experie to date."

Other transactions between Cree C&C drew fire, too. From 1998 to 2 Cree sold $6 million worth of eq ment to C&C, but the gear never Cree's premises, and Cree continue operate it. "Given that Cree is oper the equipment, it sounds like a true has not taken place," says J. ward Ketz, a professor of counting at Pennsylvania S University. Cree maintains the transaction was a legiti deal to add capacity to ser C&C and that it had set up a person committee to prevent tential conflicts of interest.

About the same time, Eric came concerned about stock s by his brother. He alleges Neal sold Cree stock before it apparent to the public that C December, 2000, acquisitio UltraRF, a wireless chipma would not work out. Tra records show that Neal 150,000 shares of Cree stock e months before Cree disclose $76.5 million write-off relate UltraRF in April, 2002. The h ings were worth more than $3 lion and made up about 30 Neal's holdings. In the two mo following the disclosure, C stock fell about 18%, to $18. says that his stock sales were of a broad plan to diversify assets—and he points out tha exercised options on 200 shares in February, 2002, and on to the shares until after April announcement. Colu University law professor Joh Coffee Jr. says the options e cise "is inconsistent with the mal pattern of insider trading

Eric says that after he be talking to the SEC in early 2 the threats picked up, inclu several phone calls in wh people have threatened his In June, Eric, his wife, and children moved to Europe. N Eric says he just wants to things right at Cree and ret to a quiet life in the States. we want to be is left alone,' says. That won't hap anytime soon: Eric return to the U.S. a court hearing Aug. 14.

By Spencer E. A in New

INTERNECINE STRIFE

Eric Hunter and his younger brother, Neal, started Cree and built it into a successful chipmaker, once worth $7 billion. Now they're entangled in a fierce legal dispute

JULY, 1987 Eric and Neal Hunter, along with several scientists, found Cree, a Durham (N.C.) company that makes light-emitting diodes (LEDs)–semiconductors that light mobile phones, car dashboards, and other electronic devices. Eric is CEO and Neal is treasurer.

FEBRUARY, 1993 Cree raises $11.6 million in its initial public offering.

AUGUST, 1994 Eric steps down as Cree's CEO because, he says, he is tired of the responsibility. Neal replaces him. Eric hands the chairmanship to Neal in July, 1995.

JUNE, 2000 Cree's revenues soar to $108.6 million in fiscal 2000, up from $62.4 million the previous year.

APRIL, 2001 Neal resigns as CEO of Cree, and President Chuck Swoboda replaces him. Neal says Swoboda effectively had been co-chief executive for years. Neal remains executive chairman.

MAY, 2001 After Eric criticizes Neal over a deal between Cree and Charles & Colvard, Eric and his wife say their family has received several threats.

MAY, 2003 Eric and his family leave for Europe to escape what he says is constant harassment and threats, some from people he says identify themselves as Cree employees. Cree denies it sent workers to follow Eric and his family.

JUNE, 2003 Eric sues Neal and Cree for $3.2 billion in damages based on alleged fraud, insider stock sales, and other charges. Neal and Cree deny wrongdoing.

JULY, 2003 Cree discloses in a financial filing that the Securities & Exchange Commission has opened an informal investigation into Cree.

TED BY OTIS PORT

ETTING THE LEAD OUT OF ELECTRONICS

AD WAS BANNED FROM PAINT AND GASOLINE IN THE S. decades ago. Now, makers of circuit boards and her electronic components aim to get the lead out of e solder in PCs and consumer gadgets, too.

Today, most kinds of solder are 63% tin and 37% lead, formula that has changed little over the centuries. But mid-2006, the European Union plans to ban lead m all new electronic equipment. Some of Japan's big ctronics companies aren't waiting that long: Sony, atsushita Electric, and Fujitsu are telling suppliers ey want to go lead-free even sooner.

Three alloys hold promise as substitutes, albeit more pensive ones. Each is 0.5% copper plus 3%, 3.8%, or silver—with tin making up the rest. In early experi- nts, all performed equally well, says Anthony Hilvers, ice-president at IPC, a trade association of circuit- ard makers and electronics assemblers. Next comes re rigorous testing. Solectron Corp. and Flextronics ternational Ltd. will run sample boards through heat- and cooling cycles every half-hour to see if the new ders hold up to 6,000 such tests. *Michael Arndt*

ON BOTH SIDES OF THE ATLANTIC, A MIGHTY WIND POWER

WIND ENERGY IS SET TO BLOW more electricity into homes. Houston's Shell WindEnergy Inc. is building its fifth and biggest U.S. wind farm 90 miles southeast of Lubbock, Tex. There, 160 turbines will rise from the prairie. When completed by yearend, Brazos Wind Farm, a joint venture with Padoma Wind Power in La Jolla, Calif., will generate 160 megawatts of electricity, or enough to power 30,000 homes. Up in southwestern Wyoming, FPL Energy of Juno Beach, Fla., expects its 80-turbine wind farm to crank out 144 megawatts by yearend.

Across the Atlantic, Britain is emerging as a wind-power champ. By 2010, it hopes to satisfy 5% to 7% of the country's total electricity demand with wind farms, some sprouting as many as 300 turbines. The scheme aims to add 6,000 megawatts of wind-generated capacity. But funding the $9.75 billion plan may be tricky because the payback on wind-energy investments can stretch to 10 years or more without government incentives. Still, Deutsche Bank predicts global wind-power capacity will double in four years. ■

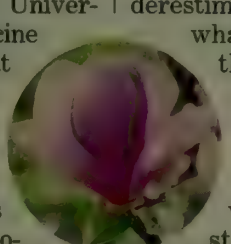
FIGHTING FOREST FIRES WITH SPACE-AGE TOOLS

WITH WILDFIRES RAGING IN A dozen states, firefighters are turning to technology to curb the recent, unusually heavy forest-fire tolls: 7 million acres last year—nearly double the annual average in the 1990s.

Some of the new tools to help the U.S. Forest Service find and fight the blazes are coming from an unexpected source: NASA. Four times a day, NASA satellite images are passed to the Forest Service's fire management center in Salt Lake City. And next summer could bring a new batch of tricks. Researchers at Rochester Institute of Technology are developing a remote-sensing system that can spot a foot-wide fire from an aircraft flying at 10,000 feet. NASA is also working to install the gear in unmanned aerial vehicles such as the robot spy planes that flew in Afghanistan and Iraq. ■

INNOVATIONS

e magnolia tree may pro- cancer patients with e than shade and flowers. ntists at Emory Univer- School of Medicine discovered that ree's seed cones ain a substance inhibits the th of new blood els, which tumors to grow. In labo- ry tests with mice, ompound—called honoki- hich is also one active in- ient in the Japanese herbal medicine *saiboku-to*—cut tumor growth by half.



■ Scientists have vastly underestimated the number of whales that inhabited the North Atlantic before the advent of whaling, say geneticists at Stanford University and Harvard University. By studying the DNA of whales, the researchers were able to estimate that there were some 2 million great whales in the 18th century—roughly 10 times more than previously thought. Their findings, published in the July 25 *Science*, are seen by conservationists as evidence that the ban on whaling should be extended for several more decades.

■ For the 4 million Alzheimer's patients in the U.S., new hope has just surfaced. Researchers at Harvard Medical School and Boston's Beth Israel Deaconess Medical Center report in the July 31 *Nature* that an enzyme dubbed Pin1 can prevent the brain's neurons from forming the deviant tangles characteristic of Alzheimer's. Comparisons of Pin1 levels in healthy vs. afflicted human brains, plus laboratory tests on mice, show that the tangles are clearly associated with an absence of Pin1. Using gene therapy to restore the enzyme to normal levels—although extremely challenging to do—might therefore arrest the progress of the disease.

THE INTERNET

OUT, OUT, DAMNED SPAM

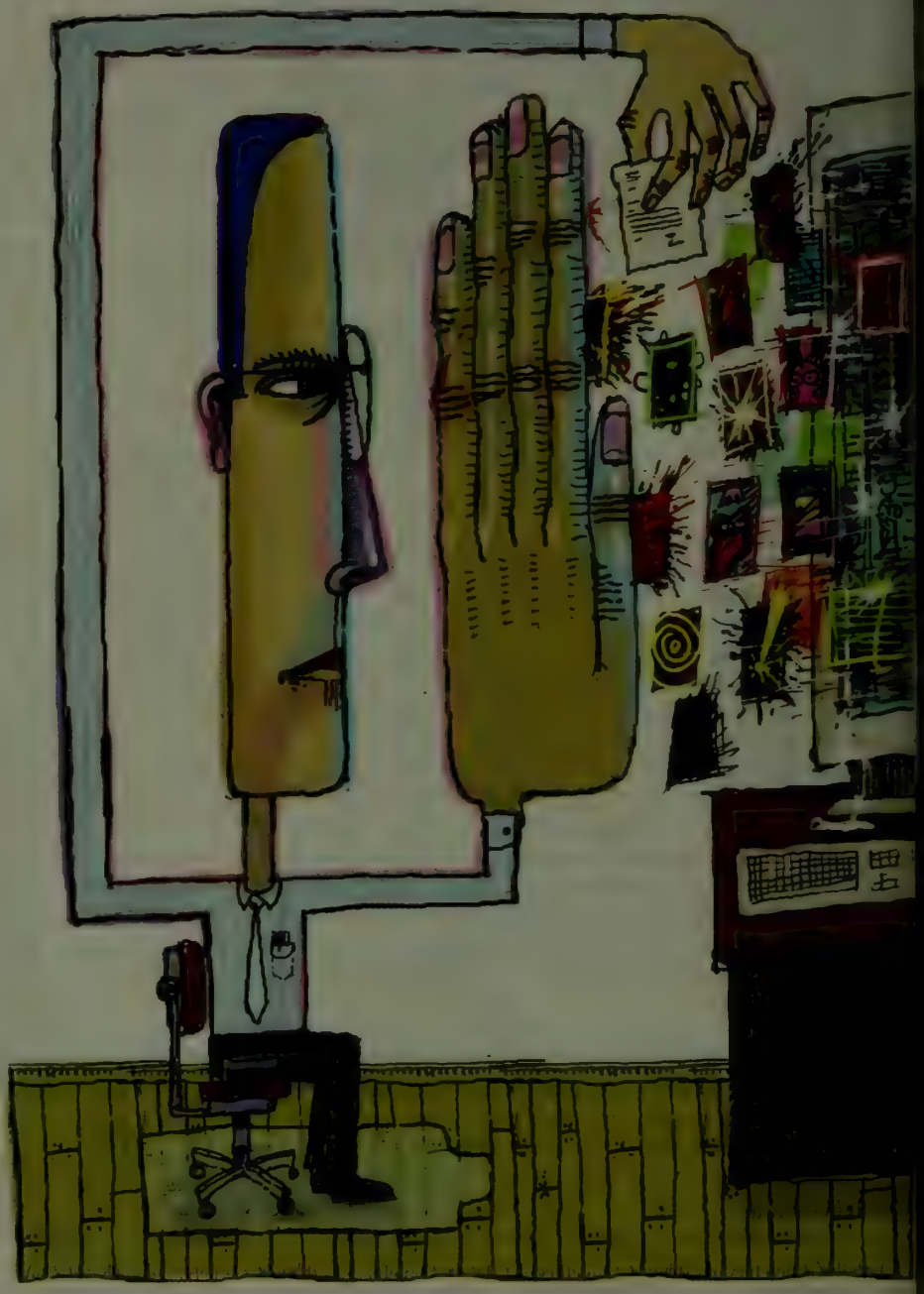
Junk e-mail accounts for roughly half of all network traffic. Here are five ways to beat it back

It was May, 1978. Lauren Weinstein was among those developing an early version of the Internet when an e-mail popped into his box. It was the first spam ever—a pitch from Digital Equipment Corp. sent, literally, to everyone on the fledgling Net. "People thought it was a little bit annoying but sort of amusing," Weinstein says.

It's not amusing anymore. Junk e-mail accounted for an estimated 49% of network traffic in June, according to Brightmail Inc., a San Francisco manufacturer of anti-spam software. These days, spam attacks Weinstein's computer every two seconds. And the Internet pioneer, founder of the Privacy Forum in Woodland Hills, Calif., is trying to save the revolutionary communications medium he had a hand in creating 25 years ago. The open architecture that made the Internet a transformative technology also has spawned the rapidly growing junk e-mail menace. "It never occurred to us that the tools we were developing for ourselves in this highly trusted environment would ever end up in the hands of the world's population," he says.

As anger at spam has increased, so have efforts to stop it. A confusing thicket of lawsuits, state and federal legislation, industry initiatives, filtering software tools, and spam-blocking companies has emerged to deal with the threat. While Congress weighs nine anti-spam bills, 34 states have enacted junk e-mail laws. Frustrated companies such as America Online, UPS, and Microsoft are hauling spammers to court.

Some of these moves are good ideas; some are bad. None of them, on their own, can eliminate spam. But a combined legal and technological attack could go a long way toward turning the scourge of spam into an occasional nuisance. Here's how to do it:



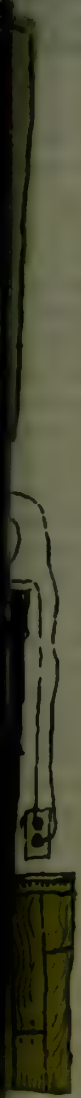
1 REWRITE THE RULES

The first step is beefing up laws against spam. Rules against snake-oil sales pitches, get-rich schemes, and other types of fraudulent come-ons already are on the books. Federal legislation sponsored by Senators Conrad Burns (R-Mont.) and Ron Wyden (D-Ore.) w go further and raise the standards spammers by requiring them to desc their messages accurately in their sul headers, use real return addresses, include working opt-out links.

That's a good idea, but it does l to slow spam. A more effective wa do that would be to let people ch

ner they want to receive it. Both
n and the European Union have
d tough "opt-in" laws that require
nercial bulk e-mailers to receive
ission from consumers before send-
nem unsolicited messages. Because
e power of the direct-marketing
, as well as constitutional free
h concerns, this approach is a non-
r in the United States. But a Do-
Spam registry, modeled after the
hat was recently created to block
narketers, would run into fewer
problems. It would enable con-
rs to opt out of receiving unso-

A combined legal and technological assault could go a long way toward turning spam from a constant headache to an occasional annoyance



d e-mail simply by logging on to a
ralized Web site.
obody expects a Do-Not-Spam reg-
to be a panacea. Dishonest busi-
people would continue to hide their
tities and flout the law. Only re-
sible bulk e-mailers—bona fide, law-
ing companies—would follow the
. How big is this group? Little hard data exist, but an April study by Australia's National Office for the Information Economy found that 18% of spam comes from blue-chip corporations.

2 CRACK DOWN

Once new laws are on the books, they must be enforced. Internet service providers and the Federal Trade Commission have hauled dozens of spammers into court since the late '90s. Every big case so far has brought a penalty. On July 21, the FTC settled with a California teen who faked return addresses on e-mails that he dangled as bait to lure consumers to legitimate-looking business Web sites. There, they were duped into giving up credit-card numbers.

Such policing is important and will have to be stepped up. But it is inherently limited. Prosecuting the small-time operators in the U.S. isn't likely to rise to the top of the docket for state and federal law enforcers with limited budgets. And using courts to crack down on bulk e-mailers is like playing whack-a-mole: knock one down and another pops up.

One solution: Give users the right to sue spammers directly and set minimum statutory damages of, say, $100 per offending message—just as was successfully done in the 1991 law against junk faxers. This "right of private action," proposed by Senator Charles E. Schumer (D-N.Y.) and others, would torment spammers with a hailstorm of private claims. Of course, Third World violators would be tough to reach. But litigators say many bulk e-mailers are domestically based, and advocacy groups such as the Spamhaus Project already do a good job of tracking down the biggest offenders. "Only when you distribute the enforcement broadly enough will it put enough fear into spammers' hearts to make them stop," says John Mozena, vice-president of the Coalition Against Unsolicited Commercial Email, a consumer-advocacy group.

3 GO GLOBAL

To discourage spammers from moving offshore, the White House needs to take the lead in harmonizing international law and beefing up global enforcement. The 30-nation Organization for Economic Cooperation & Development is working on the problem, but the Asia-Pacific Economic Cooperation forum is a vital player and needs to be at the table. The good news is that other countries are also working on this issue. EU commissioners will visit Washington in August to lobby Congress to strengthen our laws. State regulation, on the other hand, isn't working. While well-intentioned, these measures create a patchwork legal regime that increases corporate compliance costs.

4 BUILD A GATED COMMUNITY

In the Net's infancy, peer pressure deterred spam, with improprieties drawing immediate social rebuke. But the online population boom upended that cozy virtual village. "Like in any large city, some people are going to engage in unlawful behavior," says Charles D. Curran, AOL's assistant general counsel.

Cyberspace needs a new code of conduct, and it's up to industry to help write it. Internet mail protocols—the technical rules that govern how messages are transmitted—need revamping. Designed when the Net was small, they allow spammers to cover their tracks by forging headers, faking domain names, and bouncing e-mails off servers across the globe. New norms can be imposed by grafting changes onto Net protocols. Microsoft, Yahoo!, AOL, and others are studying ways to build a so-called trusted-sender system that would give priority to known or identified e-mailers. Think of it as an exclusive gated community that would be almost spam-free.

Here's how it would work: Spammers make their mail look legitimate by faking domain names. But it's much harder to forge a domain's IP address—the individual computer identifier that tells where an e-mail originated. Under trusted-sender rules, recipients' servers wouldn't accept mail unless they verified that the message originated from a valid domain, and the sender's IP address matched the number associated with the domain. If they want to be trusted senders, large e-mailers such as ISPs, corporations, and institutions would provide their IP addresses to a central registry. Fraudulent spammers would be zapped by the receiving server.

5 PRACTICE SELF-DEFENSE

Even with more cops and more spam-free zones, some bulk e-mailers will find ways to sneak their pitches into in-boxes. So consumers and companies will have to take the offensive.

The best professional filters, such as Brightmail, can block 95% of spam. At FrontBridge Technologies Inc., a San Francisco-area Internet-security company, computers check incoming e-mail against 10,000 criteria used to define spam; 500 of those rules are rejiggered every day, depending on what spam-

mers are up to at the moment. Because teams of human "spam analysts" keep tabs on the trash bin, big filtering systems rarely lose a real message amid the junk. When the San Diego law firm of Gray Cary Ware & Freidenrich installed a FrontBridge filter in December, "My greatest fear was that some critical client would get their e-mail rejected," says Chief Technology Officer Don P. Jaycox. But after six months, "The false-positive rate is almost immeasurable."

Good filtering is expensive. But assuming that Gray Cary's 420 lawyers each spent 15 minutes a day deleting spam, Jaycox figures the firm was losing $186,000 in billable hours every month. In that light, the $100,000 a year the firm spends to stop spam seems reasonable.

Effective filtering for the masses is a bigger challenge. A community of spam vigilantes constantly is improving free programs such as SpamAssassin. And AOL and Microsoft are rolling out adaptable programs that "learn" how to define spam based on what people delete. The newest filters also protect against beacons—signals that let spammers know when a spam has been opened by a live user. And some computer users are compiling "white lists," which allow e-mail from known senders to go into a premium in-box. But these consumer-level filters depend on technology alone. Without a living, breathing safeguard, chances are good that a filter will occasionally zap the wrong e-mail.

That's why many people will have to surf smart. By now, most computer users know that replying to most spam only generates more spam. Such smarts can go a long way toward eliminating junk e-mail. People who don't take action will suffer. Indeed, the recent flooding of many in-boxes is a sign that spammers are having to work harder. As e-mail filters get smarter, and as laws and lawsuits multiply, junk mail is harder to deliver. To maintain their already thin margins, spammers are upping their output, jamming more junk mail into the fewer in-boxes that remain vulnerable. "It increases the pain for the rest of us," Mozena says.

In the end, spam's greatest vulnerability is its economics: It costs very little to send out millions of e-mails, and nothing to send out a million more. Making junk e-mail even marginally more expensive for senders—by suing spammers, levying fines, or making it harder for it to find an audience—can be enough to tip the scales. Such efforts won't make spam extinct. But they can kill the majority of it—and hopefully turn spam back into a tolerable, perhaps even amusing, annoyance.

By Lorraine Woellert, with Stephen H. Wildstrom, in Washington

BASS FISHING

WILL COUCH POTATOES BITE?

Two rival tours angle for sponsors—and more viewers

Picture a Super Bowl with a fish scale as the goal line. Instead of quarterbacks diving for the end zone, logo-laden anglers rush across a stage lugging bags of wriggling bass. With music pulsating, contestants dump their catch and stand by nervously as totals are announced to a cheering crowd by a carnival barker named Fish Fishburne. Total prize money: $700,000.

Welcome to the Citgo Bassmasters Classic, the showcase of pro bass fishing and an offbeat effort to turn the art of hooking a lunker into a glitzy, made-for-TV event. This year's Classic, the season-ending show on the ESPN-owned BASS Tour, drops its line on Aug. 1-3 at the Superdome in New Orleans. Up to 25,000 diehard angling fans are expected to make the pilgrimage each day. "You'll see more heat, more passion than any sporting event you ever went to. It's dynamite," raves Ray Scott, a former insurance exec who founded BASS (table).

But will fishing shows lure armchair anglers? ESPN is betting they will. In 2001, it paid $40 million for BASS and began broadcasting the BASS Tour, which runs from January to August and stretches from fishing holes in Florida to California. Yet even though ratings for ESPN's fishing shows are creeping up, fewer than a half-million households tuned in the Classic last year, leaving it behind niche players like the L League World Series.

The rival, if less exposed, Wal-M FLW Tour, owned by investor Irwi Jacobs, holds its end-of-year Jacobs on Sept. 10-13 in Richmond, Va. On FLW Tour, televised by the Outdoor Network, weigh-ins are held in Mart parking lots, and coverage is p into the aisles. Despite a $500,000 ner's prize and plenty of hype, the Tour is hardly a ratings dynamo ei

Still, there's no doubt the fisher are out there. Some 44 million An cans fish, and spending on everyt from boats to bait—$37.8 billion year—is a powerful d for advertisers and s sors. In fact, both t are awash with spon selling to an audience BASS says is mostly and college-educated snagging Wal-Mart, FLW took the lead in g bing consumer spons It has since netted L O' Lakes, 7-Up, and S py Peanut Butter. year, ESPN signed Citg BASS title sponsor for million annually months before C dropped its sponsorshi NASCAR after 18 year Citgo spokesman s BASS offers a less costly way to re "heavy consumers of our product."

That's not to say bass fishing t are a threat to NASCAR. But a d years ago, who would have predi that millions of TV viewers would sp their Saturdays watching cars z round and round a track?

By Mark Hyn

Fish vs. Fish

	WAL-MART FLW TOUR	CITGO BASSMASTER TOUR
OWNER	Irwin Jacobs, financier	ESPN
TOURNAMENTS	7	11
TOP PRIZE	$500,000	$200,000
SPONSORS	Wal-Mart, Kellogg's, Frito-Lay, Fuji film, others	Citgo, Busch beer, Chevy, First USA, others
HISTORY	Founded by Jacobs in 1996. FLW stands for boat builder Forrest L. Wood, a big fish in fishing	BASS (Bass Anglers Sportsman Society), founded in 1968; 550,000 members

BUDGET

O LONGER HE INVISIBLE MAN

xclusive interview with new OMB chief Josh Bolten

President Bush's new budget di-ector, Joshua B. Bolten faces the nenviable task of tackling a soar-eficit that is projected to hit a \$455 billion this year. Bolten, 48, ll equipped for his new job. He rly ran the White House policy and enjoys an unusually close re-ship with the President. He has ut in stints as a Goldman investment banker, a trade r, and a Capitol Hill aide. ends what little spare time as riding his brand-new y-Davidson Fat Boy, listen-Bruce Springsteen, and g classical guitar. He lays to the highest score among Bushies at Camp David's ng lanes—207.

hough Bolten is more of a natist than an idea man, insiders expect him to be the preeminent member of s revamped economic team. some Washington veterans he may end up as the most ntial budget director since rd G. Darman, who served George H.W. Bush.

t the quiet and unassuming n could not be more different the sharp-elbowed Darman. on of a CIA operative, Bolten lmost invisible in his White e post. Yet he wielded enor-power because he had the dent's ear. Intensely loyal protective, Bolten often ed meetings between Bush is top aides, laying out the in which each adviser spoke controlling who sat where. a former Administration aide: "Josh ways a step ahead."

olten considers himself an instru-of Bush's philosophy, and if he has rsonal agenda, he has kept it well n. Among the few issues in which as expressed an interest: the fight st HIV/AIDS. Like former Treasury etary Paul H. O'Neill, Bolten has worked with rock star Bono to raise the visibility of the AIDS crisis in Africa.

On July 29, Bolten sat down with Washington Senior Writer Rich Miller and Senior Correspondent Howard Gleckman for his first full-blown interview as director of the Office of Management & Budget. He argued that the deficits are manageable as long as spending is contained, said the White House would press for more tax cuts next year, and vowed a renewed push for Social Security reform.

"The deficit we are now running is not currently causing economic damage"

— JOSHUA BOLTEN

You've called the budget deficit "manageable." How will you manage it?

I always said manageable if we continued to pursue policies to promote economic growth and exercised responsible fiscal restraint. We should not be cavalier about the size of the deficit. It's a legitimate concern. The deficit we are now running is not currently causing economic damage. We would probably see that reflected in interest rates. Even with some spike-up in the last few weeks, we still have historically low rates. But even so, we need to do whatever is possible to make sure that those deficits are on a clear downward path.

You've said you want to hold the increase in discretionary spending to 4%. How?

So far, we and Congress are doing a pretty good job of living within that. There are going to be some tough fights in September. But there is a very good possibility that [we] will meet the constraints of the budget. Going forward, we need a similar kind of discipline and possibly even more. I don't want to say we're locked in [to 4% growth in fiscal year 2005]. We should also be taking a close look at procedural ways to limit growth in spending [including] some of the measures that used to be in place, like [spending] caps, pay [as you] go [rules], and other creative measures to keep spending in reasonable bounds.

What about a flexible freeze?

That's one of the ideas that has floated by. But I don't want to take any off the table. This needs to be a partnership [with] the leadership in Congress.

Fed Chairman Alan Greenspan says we shouldn't run deficits when the economy reaches full employment. Yet your five-year budget plan would do that. How do you justify this?

We'd like to get to full employment as rapidly as possible. That's the principal motivator behind the tax cuts, to try to create jobs. Sure, we prefer to get the deficit as close to zero as possible when you're approaching full employment. In year five, the deficit will have declined substantially, to roughly 1.5% of GDP. I would rather get that closer to zero. I'm not pessimistic about our prospects.

Of getting it to zero?

Ultimately, yes. The key element in doing so is robust economic growth. It is flagging growth, along with the bursting of a stock market bubble, that reversed

the rosy projections of surplus and had us heading into deficit.

Senator Kent Conrad (D-N.D.) says this is the last chance to reduce the debt before the baby boomers retire. Your budget does not get the debt down. Isn't he right?

He's right about the large unfunded liabilities we have coming at us from the retirement of the baby boom generation in Social Security, Medicare, and Medicaid. I don't think that means the most important issue for us is to get the debt to the lowest possible number today and for the next couple of years. Trying to ratchet down the debt isn't going to solve the fundamental problem. Social Security and Medicare are structured in a way that our resources ultimately will not be able to pay for them. In the future, the systems are unstable. We need to take a very hard look at their fundamental structure.

Is Social Security reform still on the President's agenda, then?

The environment hasn't been ideal to pursue a major change in Social Security, but I think the President will want to pursue it at the earliest opportunity. The President's Social Security Commission presented a range of options for doing so, all of them built around personal accounts.

But how will you pay for the transition to personal accounts now that the budget surplus has disappeared?

There are a variety of ways. Some would require substantial borrowing. But a well-structured plan probably will make it possible to pay that back.

In his last budget, the President proposed health-care tax credits and new savings incentives, such as retirement savings accounts. But Congress didn't enact them. Will the Administration renew these in the coming year and in the campaign?

Yes. They remain on the President's priority list. We have good prospects of achieving all or most of those.

Some conservatives say that you are not a committed conservative, that you're a pragmatist and a technocrat who's too quick to compromise. Your response?

I count myself among the conservatives. The President's objectives are sound conservative objectives, and I view myself as an instrument of his philosophy and policies. If that makes me a technocrat, I wear the badge proudly. ■

THE PRESIDENCY

WHO'S THE REAL HOWARD DEAN?

As Vermont governor, the liberal firebrand was a fiscal conservative with close ties to business

Howard Dean has fought his way to the front of the Democratic pack jostling for the 2004 Presidential nomination partly because he has won the hearts of so many liberals with his antiwar rhetoric and shoot-from-the-lip style. But who is the real Howard Dean? Is he the left-of-center insurgent being portrayed in the press or the business-friendly fiscal conservative and pragmatic moderate who governed Vermont for 11 years?

Many who worked with Dean are astonished at his current image and comparisons to liberal icons such as George McGovern. "The Howard Dean you are seeing on the national scene is not the Dean that we saw around here for the last decade," says John McClaughry, president of the Ethan Allen Institute, a conservative Vermont think tank. "He's moved sharply left."

Conservative Vermont business leaders praise Dean's record and his unceasing efforts to balance the budget, even though Vermont is the only state where a balanced budget is not constitutionally required. Moreover, they argue that the two most liberal policies adopted during Dean's tenure—the "civil unions" law and a radical revamping of public school financing—were instigated by Vermont's ultraliberal Supreme Court rather than Dean. "He was not a left-wing wacko," says Bill Stenger, a Republican and president of Jay Peak Resort, who says he supported Dean because of his "fiscally responsible, socially conscious policies."

Business leaders were especially impressed with the way Dean went to bat for them if they got snarled in the state's stringent environmental regulations. When Canada's Husky Injection Molding Systems Ltd. wanted to build a new manufacturing plant on 700 acres of Vermont farmland in the mid-'90s, for instance, Dean greased the wheels. Husky obtained the necessary permits in near-record time. "He was very hands-on," says an appreciative Dirk Schlimm, the Husky executive in charge of the project.

And when environmentalists tried to limit expansion of snowmaking at ski resorts, "Dean had to show his true colors, and he did—by insisting on a solution that allowed expanding snowmaking," says Stenger. IBM, by far state's largest private employer, s got kid-gloves treatment. "We w meet privately with him three to times a year to discuss our issues," John O'Kane, manager for govern relations at IBM's Essex Junction "and his secretary of commerce v call me once a week just to see things were going."

Dean also wins accolades for his dling of fiscal policy. "He is a very man," says A. Wayne Roberts,

DR. DEAN ON THE RECORD

On the possibility of a strong recovery:

My favorite economist on Wall Street is Stephen Roach. He believes that the combination of these enormous deficits, incredibly low and potentially negative savings rates, and the enormo imbalance that we have is like sult in significant economic cal while there may be some shor provement, I think this Presid put the economic future of An jeopardy with his supply-side

On firing up the economy:

First, we need to do what C

of Lake Champlain Regional
ber of Commerce, who worked in
leagan White House in the '80s.
e is no way in heck he would tol-
a deficit." In fact, Dean resisted
from more liberal Democratic leg-
s to hike spending while pushing
gh two income tax cuts, paying
the state's debt, and funding the
"rainy day" reserves. As a result,
re now one of the few states that
good shape financially," says Jim

las, Dean's Republican successor
vernor. In fact, Vermont closed the
on its 2003 fiscal year with a $10.4
n surplus, even as California, Mass-
etts, and many other states battle
deficits.

. Dean gets more mixed reviews
s signature effort to extend health
ance to children and low-income
s. He did that by dramatically in-
ing Vermont's Medicaid program,
rupling the number of youngsters
vers. Critics argue that this ex-

pansion of government-run health care wasn't adequately funded, and tough regulations drove out many private insurers, reducing competition. Part of the cost was offset by limiting reimbursements to doctors to the point where "they are now far less than the cost of actually providing the services," says Paul Harrington, executive vice-president of the Vermont Medical Society. Still, "Medicaid is on an unsustainable track," warns Governor Douglas, who projects that the program will be losing $150 million a year within five years—a huge shortfall in a small state, though Vermont is hardly alone when it comes to Medicaid woes.

The most controversial change under Dean's watch was the overhaul of Vermont's traditional system of paying for public schools with local property taxes. The new system shifted funds from rich towns to poor towns through a "sharing pool" and raised the burden on Vermonters earning more than $75,000 a year. It sparked an explosion in education spending, "which is up 40% since 1997 even as the number of students are down 6%," says Douglas—and a firestorm of protest in wealthy towns such as Stowe. After Douglas took office, the sharing pool was eliminated, property taxes for homeowners were reduced, and the sales tax was boosted to make up for lost revenue, making the Dean education plan less controversial.

On most issues, however, Dean positioned himself as a moderate, well to the right of many members of his own party. To be sure, that was in the context of what is arguably the most liberal state in the country. Conservative critics complain that for all his efforts to help business, Dean never challenged the state's onerous regulations or heavy tax burden. "These policies really discourage development," says Richard Heaps, vice-president of Northern Economic Consulting, who advises many of his clients not to move to Vermont.

Still, Dean had a knack for positioning himself and never lost an election. Those who know him best believe Dean is moving to the left to boost his chances of winning the nomination. "But if he gets the nomination, he'll run back to the center and be more mainstream," predicts Stenger. Says Garrison Nelson, a political science professor at the University of Vermont: "Howard is not a liberal. He's a pro-business, Rockefeller Republican."

ON THE STUMP

"Howard is not a liberal," says a local prof. "He's a ...Rockefeller Republican"

Indeed, virtually everyone who has worked with Dean believes he would be a demon at reducing the federal deficit. While balancing the budget and keeping defense expenditures intact, that would leave precious little room for new liberal programs. What it more likely would leave are a lot of dashed expectations among the crowd that so fervently wants the doctor to be in.

By William C. Symonds in Burlington, Vt.

e need to make a genuine ef-
t to balance the budget to re-
tor confidence. The second
uld do is to support the small-
mmunity. They create more
large businesses do, and they
their jobs offshore. And if
taxpayers are going to invest
es with tax breaks, we ought
businesses that stay here.

On the Bush tax cuts:

There are some tax cuts that we would look at as [part of] an economic stimulus package. But right now the President's tax cuts are so irresponsible and so foolish that I would repeal all of them.

On business regulation:

My attitude is that 80% of the business community wants to do the right thing environmentally. And for the 20%...that are not helpful, there is a heavy hammer.

BusinessWeek online

For more from Howard Dean, see www.businessweek.com/magazine/extra.htm

TRANSPORTATION

FEDEX AND BROWN ARE GOING GREEN

And by buying cleaner and more efficient trucks in bulk, they'll make them cheaper for everybody else

Practically every day, more than 70,000 boxy brown UPS delivery trucks rumble to life across the country. They travel more than 1.3 billion miles annually to deliver some 4.7 billion packages, combusting tens of millions of gallons of diesel fuel along the way. No wonder United Parcel Service Inc. will try just about anything to save a few pennies for each of those miles.

The Atlanta-based shipper once developed a motor that could burn cheap corn oil.

The engine never made it out of the lab. But that hasn't kept UPS from hunting for cheaper, cleaner replacements for the old, smoke-belching diesels that power most of its trucks. "We're driven to cut costs in finding cleaner fuels," says Thomas H. Weidemeyer, UPS's COO and president of its air unit. Today, UPS's green fleet includes around 2,000 vans running on everything from compressed natural gas to electricity. Compared with standard diesel engines, the CNG vans shave 15% in fuel costs and emit 35% less pollution.

That's just a fraction of what's to come. UPS and its big rival FedEx Corp. are beginning to swap out the old diesels from their combined armada of 100,000-plus delivery vehicles. In their place, they're testing a variety of cleaner technologies, including diesel-electric hybrids and hydrogen fuel cells. In part, they're doing this to satisfy Washington's push to cut emissions, given that trucks produce more than 30% of urban smog.

The biggest motivation is cost savings, though. The delivery giants are finding that green machines, while pricey to buy, are cheaper to maintain and operate. Hybrid electric vehicles, for example, can cut fuel costs by half, while lowering emissions by 90%. Of course such big cuts in pollution also make great PR for a historically dirty industry. Still, "the driving motivation here is the bottom line," says Donald Broughton, transportation analyst at A.G. Edwards & Sons Inc. "[These CEOs] haven't suddenly joined Greenpeace."

Where FedEx and UPS lead, the rest of the nation's 5-million strong delivery fleet will follow. Over the coming decade, the price of hybrid trucks will likely fall as a result of FedEx' 30-unit order for hybrid electric vans. But so, others are ready to make a commitment. The U.S. Postal Service plans to mix hybrids into its fleet of 142,000 trucks once the price is right. "These technologies provide a huge potential for the transportation sector as a whole," says Margo T. Oge, director of the office of transportation and air quality at the Environmental Protection Agency.

This movement started with small steps. In the late '80s, UPS invested heavily in CNG-powered trucks. Even after Washington revoked its backing—and funding—for CNG a few years into the decade, UPS continued to build the necessary infrastructure. Since 1998, it has been testing a hybrid electric van. And UPS is also expanding its fleet of ultra-low-emission diesel trucks to 5,000 from 3,200. This year, UPS will work with the EPA and DaimlerChrysler to test the first hydrogen-powered fuel-cell delivery truck in the U.S.

FedEx is tinkering with its fleet, too. In May, the Memphis-based company announced it had bought 20 hybrid delivery trucks, the vanguard of a program that will eventually replace its entire fleet of 30,000 express delivery vans. "FedEx really raised everybody's eyebrows," says Fred Silver

CLEAN DELIVERY

Big shippers are racing to lower pollution—and cut costs

UPS	FEDEX
• Is testing the first delivery truck powered by a zero-emission, hydrogen-powered fuel cell	• Plans to replace 30,000 air express vans with hybrid gas-electric models in the next 10 years
• Operates 1,000-plus natural gas-powered vans that emit 95% fewer particulates than diesels	• Says the move will boost fuel efficiency 50% while lowering particulate emissions by 90%

YOUR BUSINESS IS ALL ABOUT PERSONAL ATTENTION. NOW, SO ARE WE.

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ARRIVE SAFELY.

rector of business initiatives at WestStart, a nonprofit transportation technologies think tank in Pasadena, Calif.

Hybrids are nothing new, to be sure. Toyota Motor Corp. and Honda Motor Co. sell passenger cars powered by mixed gas-electric motors. But FedEx is the first in this country to try to adapt the technology for diesel delivery vehicles on such a large scale. Mitchell Jackson, FedEx' managing director of corporate and international environmental programs, boasts: "We've got the most innovative project on the ground in the industry today. This is not a demo. It's a commercial vehicle."

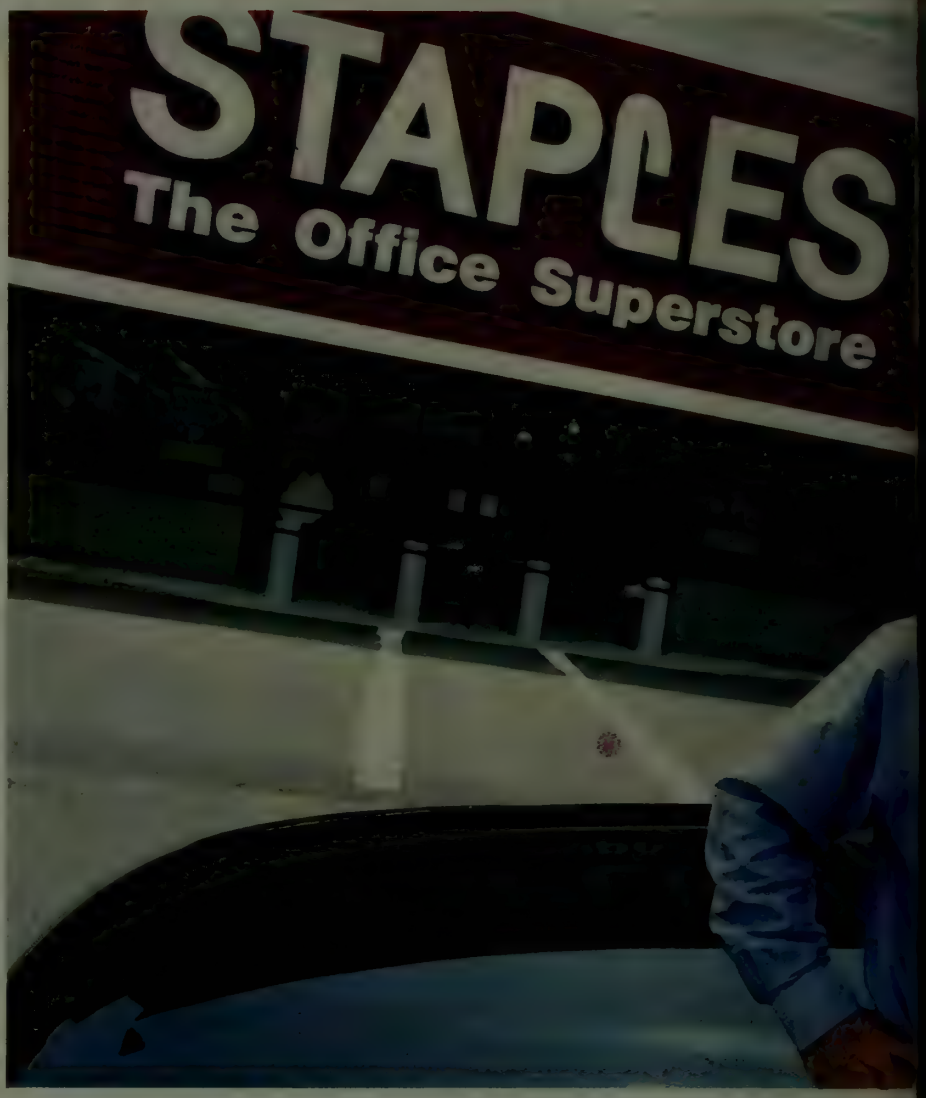
Indeed, most experts—even those at UPS—believe hybrids offer the best near-term promise. Hybrids combine a high-efficiency diesel or gas engine with an electric motor. A computer orchestrates how to channel energy around the engine, the electric motor, and the wheels most efficiently. Hybrids require less maintenance because they run cleaner. Plus, the braking systems last longer because the motor itself helps slow the vehicle down—in a process that recaptures much of the energy used in decelerating. Between fuel savings and lower maintenance costs, FedEx claims it will break even on the hybrid vans in about a decade.

The scale of FedEx' commitment is likely to transform the economics of hybrid commercial vehicles. What are now exotic custom-builds could soon become mass-produced and less expensive. Smaller players could then consider hybrid trucks. "FedEx is taking a big gamble," says Andrew J. Hoffman, a Boston University professor who specializes in corporate environmental strategies. "But it's a gamble that should jump-start the commercialization of this technology."

Cleveland-based Eaton Corp., which makes the key electro-mechanical power systems for FedEx' hybrids, says it expects to sell up to 30,000 such units within the next five years—and not just to FedEx. "This should be a substantial new business for us," says Tim J. Morscheck, Eaton's vice-president of technology in the trucking division. Morscheck believes the hybrids will get cheaper as sales volume grows.

The numbers are beginning to add up. In a recent report, consumer consultant J.D. Power & Associates Inc. estimated there will be more than 500,000 hybrid vehicles on the road by 2008—40% of them trucks. After years of experimentation, UPS and FedEx are now ready to deploy green vans in a big way—possibly heralding the end of the smoke-belching delivery van.

By Charles Haddad in Atlanta, with Christine Tierney in Detroit



STRATEGIES

THINKING OUTSIDE THE BIG BOX

New Staples boss Ronald Sargent has charged up profits. Now he's headed in daring new directions

Two years ago, Staples Chairman Thomas G. Stemberg and then-President Ronald L. Sargent approached Microsoft Chairman William H. Gates III and CEO Steven A. Ballmer for some unusual career counseling. Stemberg, the visionary who founded Staples and built it into one of the most successful big-box retailers of the '90s, was itching to turn the job over to longtime lieutenant Sar and move on to other things in his much in the way Gates had passed reins to Ballmer. The timing looked rible, though. After years of bliste growth, Staples seemed to be hitti wall—sales had stalled, while profits the stock were cratering. After a meeting at Microsoft headquar Ballmer—a classmate of Sargent Harvard University—urged them ahead anyway. He predicted, "You fine," Stemberg recalls.

Ballmer was right about Sar Since the baton was passed in Febr

2002, the low-key, notoriously frugal CEO has seamlessly taken command and outpaced the rest of the industry, allowing the more flamboyant Stemberg, 54, to assume the role of "entrepreneur in residence." But now Sargent, 47, faces a much tougher transition. The market for the office superstores that drove Staples' meteoric rise is maturing, as everyone from Wal-Mart Stores Inc. to the local drugstore peddles cheap office supplies. To fuel a second burst of growth, Sargent is thinking far outside the big box. His audacious aim: to nearly double Staples' sales to $20 billion within the next five or six years, while boosting net income more than 20% a year on average.

To get there, Sargent envisions tearing up Staples' old image as just a purveyor of r clips and PCs at its 1,300 North rican superstores. He sees huge opnities in the highly fragmented of delivering office supplies from houses directly to businesses. Ultily, he believes the delivery busicould equal sales of the better-n stores. That would be a radical rture, since it means Staples would uch more business than it does with large corporations. He's also ging into Europe. And he's counting ily on selling services, including ing, UPS shipping, and such new tives as mobile technicians who fix uters and install networks.

me outsiders question whether Sarcan pull off such an ambitious transation. For one thing, with the $450 n North American and European et for office supplies growing only t two percentage points faster than economy, Staples will have to get of its growth by wresting it away competitors. And it will have to stores into markets such as Chicago Houston, now dominated by Office-Inc. and Office Depot Inc.

Europe, Staples is playing catch-up to Office Depot, which in June acquired a French delivery business that doubled its European sales. And in the delivery business, Staples trails both Office Depot and Boise Cascade Corp., a leader in serving large companies. On July 14, Boise Cascade announced a deal to buy OfficeMax for $1.15 billion, thus broadening its reach into small business. Cautions Geoff Wissman, vice-president at consultants Retail Forward Inc.: "The market is fairly saturated, and the competitive intensity has increased."

Still, Sargent has made a career of confounding critics. His first big challenge came in 1990, when Stemberg asked him to take on Staples' then-$20 million delivery business. "We were like the bad guys inside Staples," recalls Sargent, "because the feeling was that if customers got products delivered, they wouldn't shop our stores." Today the $3.4 billion delivery business has Staples' highest operating-profit margins. As CEO, Sargent's sharp eye for cutting costs has helped him boost profitability, despite a tough economy. Sargent may have pulled down a salary and bonus of $1.9 million last year, but the son of a mechanic hasn't lost his blue-collar touch. He still keeps key financial data inside a five-year-old file folder that has been heavily taped to hold it together, and he drives an 11-year-old Toyota Camry.

Upon taking over as CEO, Sargent cut back on selling PCs and other low-margin items. He put the brakes on store expansion—Staples will open no more than 75 stores a year going forward, he says, down from 133 as recently as 2000. And he set up 45 task forces to find savings on everything from store leases to paper. The payoff? Operating-profit margins jumped to an industry-leading 5.9% of sales last year, from 4.5% in 2000. Net income surged to $446.1 million, from $265 million in 2001. And sales rose 8%, to $11.6 billion, last year, after barely budging in 2001. That has driven the stock to around $20, up from a low of $12 last fall.

Now the question is: Can Sargent work the same magic on the top line? Despite more than a decade of superstore growth, the business is still highly fragmented. In the delivery business, for instance, there are some 6,000 locally owned independent dealers, with average sales of just $3 million. Europe is even more ripe for consolidation.

But Staples faces daunting hurdles on the Continent. Far behind Office Depot in the delivery market, Staples last October bought the mail-order business of France's Guilbert for nearly $800 million. That boosted European delivery sales from $50 million to $450 million overnight. But partly because it still relies heavily on stores, Staples earned just $4 million on revenue of $1 billion in Europe last year, while Office Depot earned $212 million on sales of $1.6 billion. "They've struggled for the same reasons a lot of American retailers have had problems in Europe," including the high cost of land and restrictive rules in countries like Germany, says Office Depot CEO Bruce Nelson.

Investors seem willing to give Sargent the benefit of the doubt, as long as he's outperforming the competition. "They'll be a big beneficiary when the economy rebounds and small business expands," predicts Kevin Beatty, an analyst at MFS Investment Management, a major shareholder. Still, retailers have stumbled over far less ambitious expansion plans. Staples needs near-flawless execution if the handoff from Stemberg to Sargent is to go down in retailing circles as something akin to Gates-to-Ballmer.

By William C. Symonds in Boston

NEW FRONTIERS FOR STAPLES

Staples gets 58% of its sales from 1,300 North American office supply stores. But as growth slows, the chain is looking elsewhere to expand:

DELIVERY Staples thinks it can take business from some of the 6,000 small dealers in this fragmented $115 billion U.S. business.

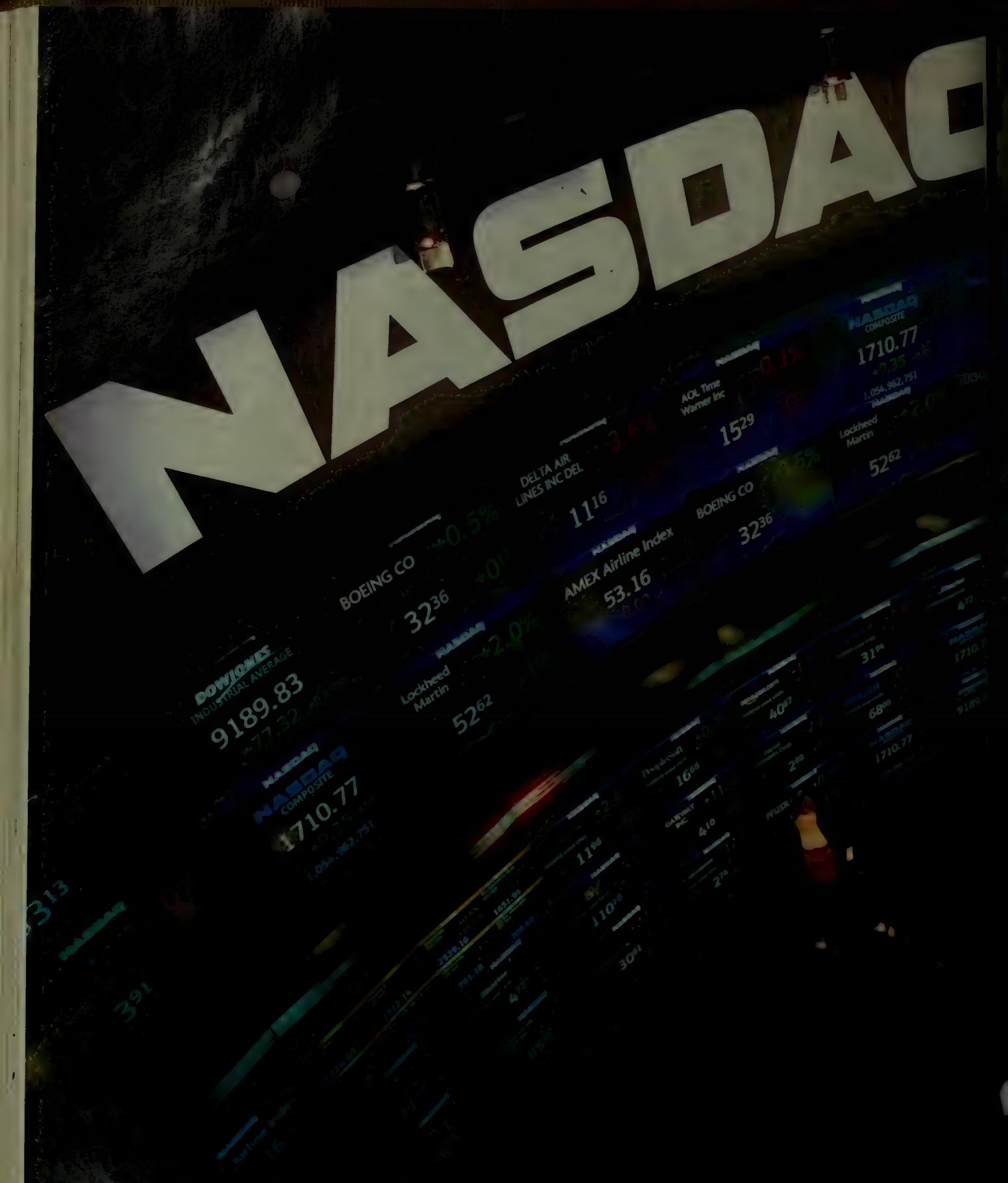
EUROPE Staples has 200 superstores there. But most of the action is in deliveries, where Office Depot has a solid lead.

SERVICES Staples is pushing copying and shipping, and testing a whole lot more

SHARE OF SALES IN 2002:

29% 9% 4%

Data: Staples Inc., *BusinessWeek*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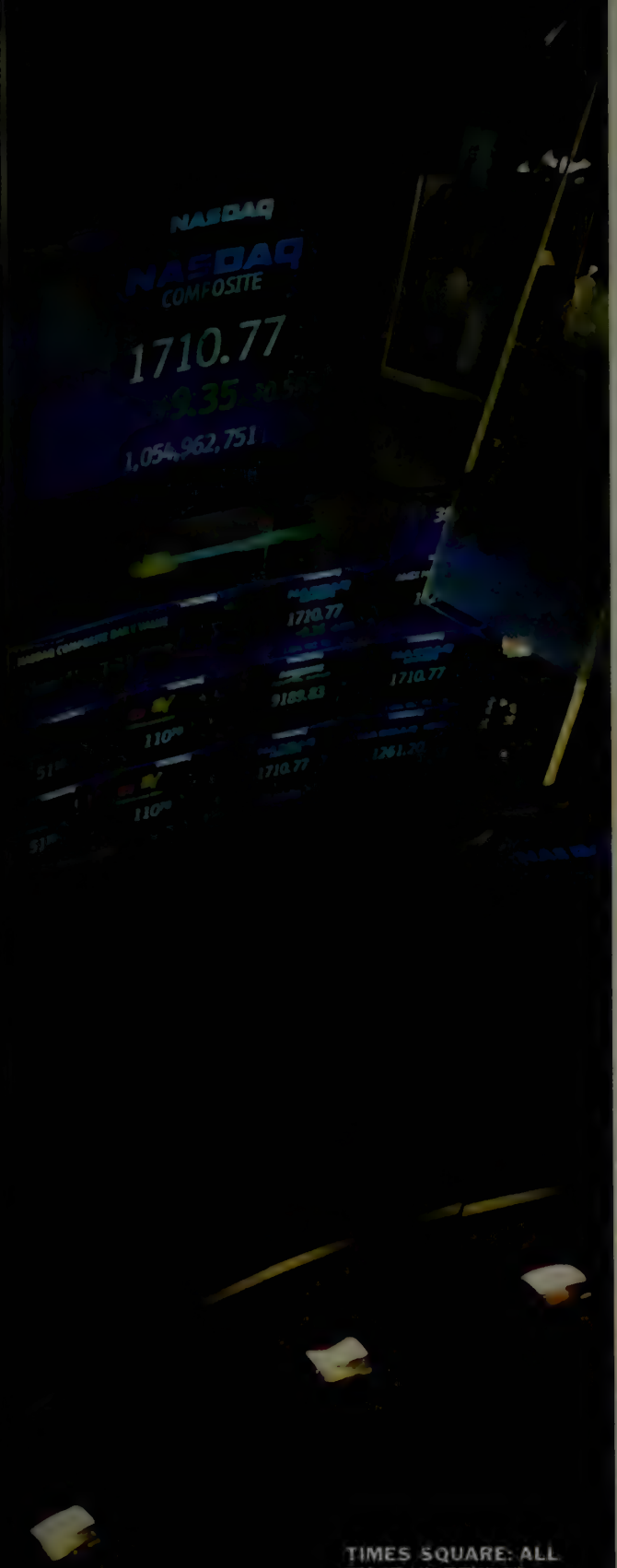


TIMES SQUARE: ALL THAT GLITTERED

S LIFE

The once-dazzling market is on the ropes as the bear market, fierce competition—and hubris—take their toll

BY PAULA DWYER AND AMY BORRUS

Robert Greifeld likes to run. "It blows off the tension and gets my mind focused," he says. So he ran a marathon in Ottawa on May 11, and when he reported to work in Lower Manhattan's One Liberty Plaza as the new CEO of the NASDAQ Stock Market the next day, he knew exactly what he had to do: By 8 a.m., the top layer of management was gone.

Then he started axing a long list of overseas and domestic ventures. Within six weeks, he killed off NASDAQ Europe, an effort to build a European version of the U.S. market that had attracted only 36 companies in five years. He canceled a joint venture with a London exchange to trade stock futures. He shelved plans for NASDAQ's own splashy initial public offering. And he nixed a new system for trading small-company stocks in the U.S. "When Bob came in, there were a lot of fires that needed to be put out," says F. Warren Hellman, whose Hellman & Friedman LLC venture-capital firm is NASDAQ's largest private owner.

The fires aren't all doused. Unbeknownst to all but a handful of insiders and industry players, NASDAQ is fighting for its life. Three years in the crushing grip of an ugly bear have squeezed all stock markets, and NASDAQ's franchise technology stocks have been especially hurt. But NASDAQ's problems run far deeper than others'—and are largely self-inflicted. Its recent history resembles a Greek tragedy of epic proportions, complete with management miscues, fierce infighting among constituents, costly regulatory misunderstandings, greed, and a big dose of hubris.

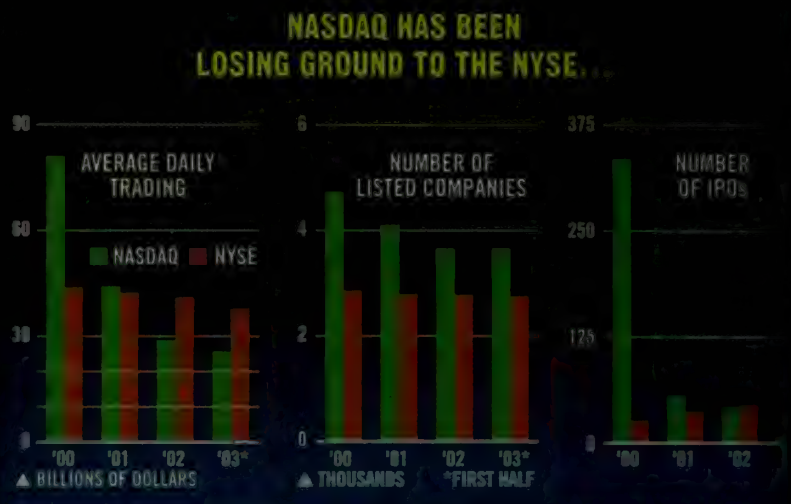
Cover Story

The question now is: Will NASDAQ survive as a thriving market for tech stocks? It is under assault on all sides. While it pursued a business model that faced tortuous regulatory delays, superfast electronic communications networks (ECNs) such as Reuters Group PLC's Instinet, stole its lunch. As a result, ECNs have snatched almost half the trading volume in NASDAQ-listed stocks, or 2½ times as much as NASDAQ's own trading system. What's more, the market famed for its boom-era IPOs is getting a run for its money from its old-line rival, the New York Stock Exchange, which nabbed 45 IPOs last year, three more than NASDAQ, according to Thomson Financial. Combined with the tech bust, the harsh competition drove NASDAQ back into operating losses late last year—sparking a boardroom revolt that put the 46-year-old Greifeld, who had launched one of NASDAQ's electronic competitors, in the hot seat. The board's marching orders: Cut overstuffed operations to the bone.

Unless they're resolved soon, NASDAQ's problems could seriously hobble tech companies' ability to raise capital just as

CHARLIE SAMUELS

THE DECLINE OF A MARKET



the tech sector starts to revive. "NASDAQ is on the cusp of meltdown," warns Jefferies & Co. analyst Charlotte A. Chamberlain. "If it self-destructed, it would leave a huge dent in the economy." Since 1971, NASDAQ has been the gateway to capital for thousands of small companies, linking entrepreneurs with investors willing to fund their dreams of expansion. In a world without NASDAQ, innovative but risky high-tech companies might be forced to delay a public listing for years. They could go to a small regional exchange such as Philadelphia's. But the only comparable alternative would be to list on the NYSE, which requires a solid track record of revenues and profits. Without a thriving central market for tech stocks, venture capitalists would have to nurse fewer infant companies for far longer. "If NASDAQ suddenly imploded," says Mark G. Heesen, president of the National Venture Capital Assn., "I don't know where these companies would go."

For the moment, Greifeld's toughest challenge is coping with NASDAQ's regulator. For nearly three years, NASDAQ has pressed the Securities & Exchange Commission to let it break free of its parent, the National Association of Securities Dealers, and operate as a stand-alone stock exchange. That would allow it to raise more capital to fight the ECNs and the Big Board. The SEC hopes to take up NASDAQ's application this fall.

BusinessWeek has learned, however, that the SEC is unlikely to approve the application anytime soon. Agency officials see fundamental flaws in the way NASDAQ trades that, they argue, could harm investors. But NASDAQ can't revamp its plan without losing the support of its main players, the big Wall Street brokerage houses. If the stalemate persists—and so far neither side is offering a compromise—a schizophrenic NASDAQ will remain stuck between its old persona as a regulated utility and its new identity as a for-profit company, with few good options for securing its financial future. Privately, some SEC commissioners say they worry about NASDAQ's ability to recover its footing.

NASDAQ's current woes spring from its structure. Unlike the NYSE, it isn't an exchange—a market with a single order book showing the trading interest in stocks among retail investors, mutual funds, pension funds, and hedge funds. At the NYSE, the vast majority of orders come together on the trading floor, where bidders fight to get the best prices. NASDAQ has no trading floor; instead it runs over a sophisticated telecom network linking about 600 customers in 1,000 tions. Quotes and orders come from three major sou market-makers, or dealers, such as the trading desk Goldman Sachs and Charles Schwab Capital Markets ECNs, some of which are backed by the big Wall Street f and online brokers such as E*Trade and AmeriTrade. NA collects and displays everyone's data, then consolidates into a single tape.

SuperMontage—the snazzy $107 million order-mat system rolled out last year—was supposed to give NASDA first shot at running its own trading book. But it put NA in competition with its own customers, the ECNs and de

GREIFELD'S GAME PLAN

CEO Robert Greifeld must persuade key players to see things NASDAQ's way–and it's an uphill struggle. His agenda and the outlook:

GO INDEPENDENT

Greifeld hopes to convince SEC commissioners that NASDAQ should become a stand-alone exchange.

OUTLOOK Grim. SEC Chairman Donaldson may balk unless NASDAQ sends customer orders to traders with the best prices. NASDAQ can't yield without losing its biggest dealers.

FIGHT FOR LIST

Greifeld plans to cou NYSE-listed compan promising greater liq better service, and m stable prices.

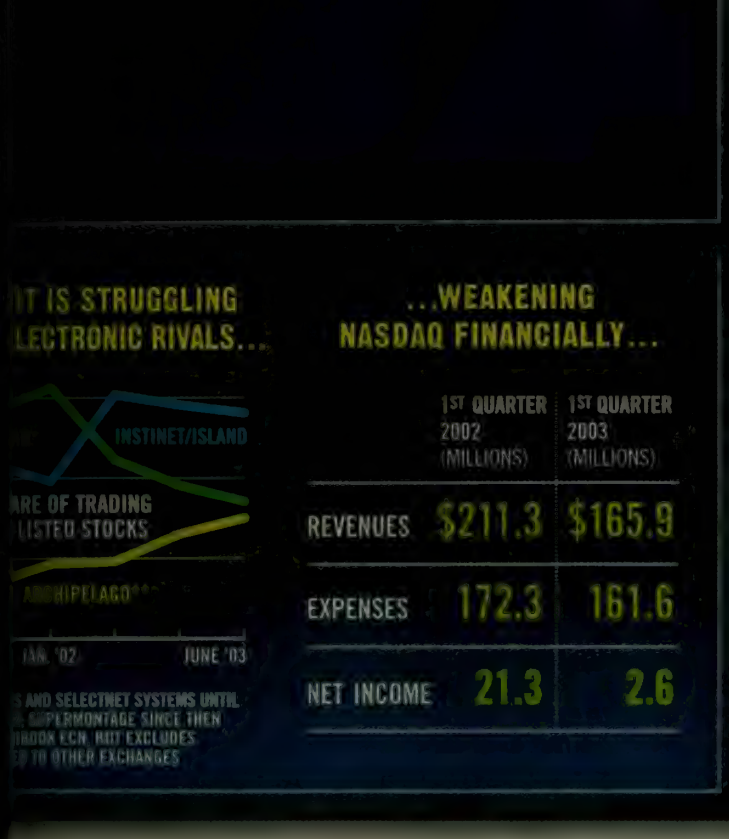
OUTLOOK Doubtful. years, only one comp left the NYSE for NA Meantime, Archipela seeking IPOs.

BOOST TRADING

Greifeld plans to be SuperMontage to re market share with s features as anonym trading and more fle how traders can ent

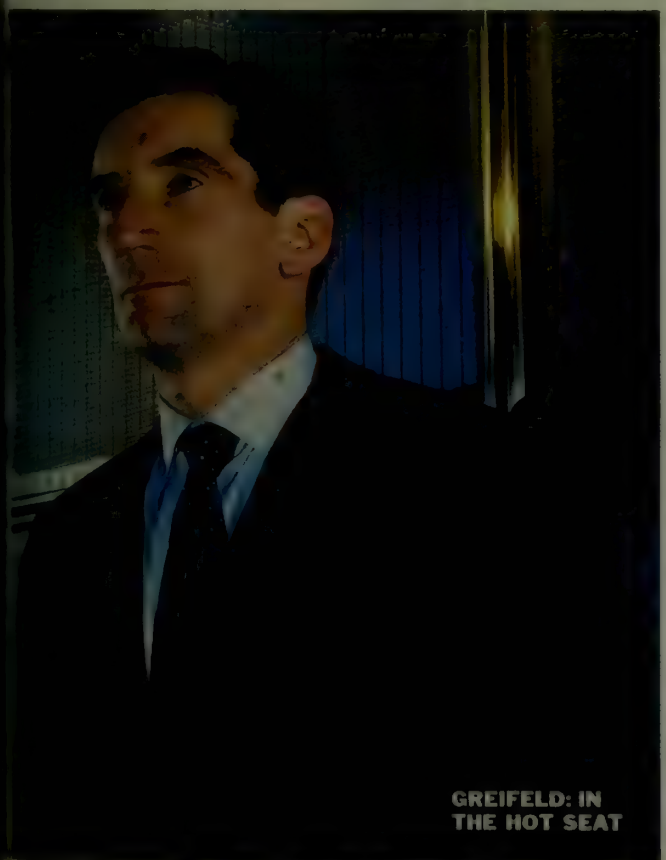
OUTLOOK Promising features will bolster SuperMontage's app big institutions, the key clients.

Data: *BusinessWeek*



its background as a trading utility under the thumb of which still owns 55% of its equity, left it ill-equipped to ttle with the eager innovators. "NASDAQ was a govern--like bureaucracy trying to be a startup," says Joseph oard, president of Wave Securities LLC, a brokerage d by Archipelago Holdings PLC, an ECN. "First it had to out the politics...and whose ox was being gored. It was ation by committee, and it showed."

SDAQ's former bosses say their ambitions were well- for the late '90s boom era. Frank G. Zarb, the Wall t veteran who pushed NASDAQ's expansion as chairman EO from 1997 to 2001, thinks the global trading he pro-



GREIFELD: IN THE HOT SEAT

moted, and even his proposed NASDAQ IPO, will be realized one day. "I can't think of a single decision that I would have made differently," says Zarb, who is now a managing director at Hellman & Friedman. "The story simply is not finished."

The next chapter will be written by a down-to-earth manager. Greifeld has all the right credentials to halt NASDAQ's slide. The board plucked him from SunGard Data Systems Inc., where he was an executive vice-president. A native of Queens, N.Y., he sold computers to the Street for Burroughs Corp. (now Unisys Corp.) while studying nights for his MBA at New York University's Stern School of Business. The topic of his 1986 thesis: how automation would make institutions the dominant force in NASDAQ trading. In 1991, he joined Automated Securities Clearance Ltd. (ASC), where he spearheaded the development and marketing of BRASS, the system that most Wall Street trading desks still use to manage their orders of NASDAQ stocks. He understands NASDAQ's ECN challenge firsthand; in 1998, he led a team that developed an ECN called BRUT, which now handles about 5% of trading in NASDAQ stocks. After SunGard bought ASC in 1999, netting him stock now worth $47 million, he melded a bevy of business units into a one-stop info-tech shop for Wall Street's back offices. "What Bob is very good at is coming up with a clear road map and relentlessly executing that plan," says SunGard CEO Cristóbal Conde.

Cover Story

Greifeld's first goal is to mimic the ECNs' nimble order-matching systems. Soon, he plans to go on the offensive against the NYSE with the aim of persuading companies to switch from the Big Board. "We're fast and electronic," boasts Greifeld. "The competition is slow and manual." It's a message he hopes will bring NASDAQ closer to his third goal: persuading the SEC to let NASDAQ break free from NASD and become a full-fledged exchange.

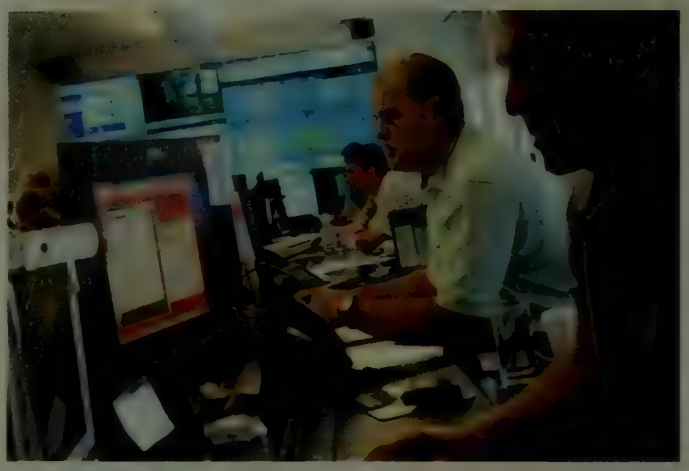
The new CEO contends that NASDAQ naysayers miss the big picture. The market has a $490 million war chest. And despite the puny 17% of trading volume that SuperMontage captures, NASDAQ maintains that 68% of all trading volume passes through its computers, if only to be reported on its consolidated tape. Resale of that data to vendors such as Bloomberg LP generates about $75 million in annual rev-

NASDAQ'S ROSTER OF LISTED COMPANIES HAS SHRUN

enue. "NASDAQ is a big tent, and SuperMontage is one player under the tent," says Greifeld. Acquiring an ECN rival such as Archipelago, which Greifeld does not rule out, could lift NASDAQ back to the top of the pile.

The NASDAQ name, burnished with expensive marketing campaigns and a glitzy MarketSite on Times Square, is still magic in many circles. Last year, JetBlue Airways Corp. chose NASDAQ over the NYSE for its IPO because "NASDAQ's image as young and efficient is consistent with that of JetBlue," says CEO David Neeleman.

If all the stars align, NASDAQ could once again become a valuable property. Freed from NASD, the market could issue more stock to acquire competitors and bolster its own trading system. It could drive a harder bargain to cut the $70 million a year it pays NASD for regulatory oversight. And eventually a more measured approach to global expansion through joint ventures and branding could plant the NASDAQ flag firmly in key European and Asian trading centers.



ARCHIPELAGO Greifeld could try to buy market share by acquiring it or another ECN

But Greifeld's game plan is fraught with risk—and depends on decisions largely beyond his control. His efforts to make NASDAQ more ECN-like are alienating the traditional dealers who form the market's backbone. Persuading the SEC's five commissioners to set aside objections by the agency's senior staff to NASDAQ's exchange application will be a tough sell. And persuading NYSE-listed companies to switch to NASDAQ is an uphill job, too. In the past 3½ years, 109 companies have moved to the NYSE from NASDAQ. In NASDAQ's 32-year history, only one company—Aeroflex Inc., a Plainview (N. Y.) microelectronics company—has made the trek in reverse. Why would Greifeld think he can overcome such odds? "What choice does he have?" asks Hellman.

Such fatalism would astonish anyone familiar with the unbeatable market that NASDAQ seemed to be at its peak in 2000. Since then, its roster of listed companies has shrunk by 27%, while NYSE listings are off just 4%. NASDAQ is likely to break even at best this year, says analyst Chamberlain. That's going to force it to eat into its cash hoard, which it needs to pay down a hefty $430 million in debt, more than half of which is due in 2006. And although its shares trade on the Over the Counter Bulletin Board, NASDAQ would find it hard to tap the public equity markets for capital because it's still technically owned by NASD, a nonprofit trade group.

For the past three years, NASDAQ has suffered through the same sluggish economy and bear-market doldrums that felled many of its once-illustrious companies. A sour economy hits NASDAQ in all four of its major revenue sources. Wall Street firms retrench, leasing fewer NASDAQ trading terminals. As companies falter, their stocks are delisted, cutting NASDAQ's fee revenue. When listings decline, the market receives fewer quotes from market-makers and ECNs and can't collect as much from reselling the data. As fewer shares trade, transaction fees shrink. Compounding those cyclical problems: When NASDAQ applied for exchange status, it gave up its monopoly over selling trading data—cutting tape revenue by $25 million over two years.

Revenue and earnings are sliding. In the quarter ending Mar. 31, revenue came in at $166 million, 22% below the same quarter last year; ne come was a paltry $2.6 mi down a hefty 88%. Despit recent surge in share tra analysts don't expect sec quarter results, due ou Aug. 5, to be much bette cause of the cost of shutt numerous sideline venture

NASDAQ's problems ca traced to a mid-1990s pric ing scandal that severely nished its image and mad SEC ultracautious about gi ng it any regulatory favors investigation showed that ket-makers were ignoring tomer limit orders that of better prices than dealers ed to post. In the cleanup SEC ordered dealers to post such prices but gave them th tion of routing the unwanted orders to ECNs, thus enco ing a host of new ECNs.

The scandal also led then-SEC Chairman Arthur Levi to recruit Zarb, who first dreamed of turning NASDAQ int world's primary equities market. In the frothy atmosphe 1999, he spun a grand vision of a 24-hour global ma place. The NASD board agreed to convert NASDAQ to a for-

HOW THE ECNs STOLE THE SH

In the past few years, electronic communicati networks, or ECNs, have outmaneuvered NASDAQ. Here's how they did it:

LOW COSTS ECNs are cheaper because they are larg computer-driven matching engines. NASDAQ's Super system still requires institutions to use a middleman moving fast to mimic the ECNs.

COMPLETE ANONYMITY ECNs keep their customers' a secret at all times. On SuperMontage, only posted are anonymous. Buyers and sellers are revealed once is completed, tipping off the market that more such may occur. Later this year, NASDAQ will adopt comp anonymity.

SPECIAL FUNCTIONS ECNs offer a variety of order-d functions to tease out buyers and sellers. A pegged o example, lets a fund sell a portion of its inventory, tr out more shares as bids move up. A discretionary orc fund buy shares as soon as a seller appears within a able range rather than wait for a specific price. NAS offer similar functions later this year.

REBATES ECNs have paired with regional exchanges get a share of the revenue for stock-price information once went exclusively to NASDAQ. The ECNs use so the revenue to give customers rebates, a practice NA hopes to mimic once the SEC lifts a rebate ban, as e

Data: *BusinessWeek*

mpany, spin it off as a stand-alone exchange, and even-
y do an IPO to raise capital for NASDAQ to spread its
d worldwide. Even the collapse of tech stocks starting in
:h, 2000, couldn't cool NASDAQ's ardor. A special meeting
ASD members approved the restructuring on Apr. 14,
—the day the NASDAQ composite index plummeted 355
:s, its largest-ever point drop.

hindsight, Zarb's plans were overly ambitious. Worse,
rchitects of the new market badly misread the SEC. At
the agency was supportive. It approved NASDAQ's for-
t status and allowed it to issue securities representing
t half the market's value to NASD members, listed com-
:s, and investors. But the SEC balked when it came to the
questions of how a NASDAQ exchange would operate—
it hasn't budged for nearly three years.

ıe main issue: "price-time priority," or making sure that
mers who first offer the best price for a stock have
orders filled first. NASDAQ has never done that. For
t a third of trades, dealers match buyers and sellers in
own order books—without giving any other market
cipant a chance to fulfill the order. The resulting "inter-
ed" trades are then reported to NASDAQ as done deals.

ıe SEC values price-time priority because it rewards the
aggressive buyers and sellers and produces fairer prices.
so ensures that market insiders don't ignore retail in-
ors. The SEC has never approved an exchange that did
orce orders to interact—and officials say it's not likely to
o soon. But NASDAQ's market-makers count on these highly profitable in-house trades, on which they collect commissions from both the buyer and seller plus the spread between the buy and sell prices. "If NASDAQ implements price-time priority," says Larry Leibowitz, head of equities for Schwab's trading unit, "the whole market-maker model comes into question—and all bets are off." Dealers are vital to NASDAQ because they keep trades flowing—by posting quotes, maintaining an inventory in the stocks they handle, and putting up their own capital as buyer of last resort in disorderly markets. A market that depended solely on ECNs, which don't have such obligations, could break down under stress.

So NASDAQ is caught in a dilemma: The SEC may not let it become an exchange unless it alters how it works. But if it changes the way it works, megadealers such as Schwab and Knight Securities might flee, further reducing NASDAQ's relevance.

Cover Story

To NASDAQ officials, the SEC's attitude smacks of favoritism toward the NYSE, which says all the orders that its specialists handle get price-time priority. They're careful not to blame SEC Chairman William H. Donaldson, who once headed the Big Board. But they complain the SEC is holding up NASDAQ over a theoretical possibility that the best-priced orders won't get filled. "It's like looking at a corner of the Sistine Chapel and complaining about a smudge," says Edward S. Knight, NASDAQ's general counsel. "You've got to look at the whole picture."

NEW YORK LIGHTS The name is still magic for some, such as JetBlue, which listed on NASDAQ last year

SEC officials say they're not wedded to the Big Board model. After all, the agency let Archipelago, an all-electronic trading system, merge with the Pacific Stock Exchange—proof, they say, that the SEC is open to new models. Archipelago was able to win over the SEC in part because it has price-time priority.

NASDAQ executives are furiously churning out statistics to placate the SEC. Greifeld's team insists that investors get high-quality order executions. One study of trades done in January shows that a NASDAQ customer has a 93% chance of landing the market's best posted price, or better, on an order for fewer than 500 shares of a stock in the Standard & Poor's 500-stock index—the typical individual investor's order. On the NYSE floor, the study says, only 76% of such orders get the best market price or better.

NASDAQ further claims that spreads between buy and sell prices are narrower on its stocks than the NYSE's. In May, NASDAQ says, the average spread on Cisco Systems Inc. shares on NASDAQ was 0.7¢, vs. 1.4¢ for AT&T, a comparably priced stock that trades on the NYSE. NASDAQ hopes that its performance, combined perhaps with new disclosures, will sway the SEC. The NYSE says NASDAQ's data are selective and misleading.

To make his case, Greifeld met with key lawmakers and SEC commissioners in mid-July in Washington. The SEC seems ready to bring the issue to a head this fall, after spending almost two years dealing with corporate and accounting scandals. Annette L. Nazareth, director of the SEC's Market Regulation Div., and other senior staff have been briefing Donaldson and other commissioners on the issue.

No one is saying how the SEC will rule. A minority of commissioners is thought to be sympathetic to NASDAQ's argument that its market doesn't need price-time priority if it executes orders swiftly and at fair prices. But the staff, wary of NASDAQ's past transgressions, would like rules to

ensure that the best orders always get filled first. The key player is the chairman—and Donaldson's NYSE background and instincts seem aligned with his staff's insistence on price-time priority. "Competition between buyers and sellers is the essential competition, not the competition between market centers," Donaldson told *BusinessWeek* in June.

And if the SEC rejects the exchange petition? "They can continue to do business just as they are," says Nazareth. But that would leave NASDAQ in purgatory. At the SEC's insistence, NASD remains NASDAQ's regulator—and keeps voting control of the company. As long as NASD can call the shots, investors aren't likely to scarf up NASDAQ shares in an IPO. And relations between the two are increasingly bitter, as they feud over details of their separation and the relatively high price NASDAQ pays for regulation compared to ECNs.

Even as it struggles with a messy divorce and an uncertain future, NASDAQ must clean up the shambles of its broken ambitions. Many of NASDAQ's global ventures—one board member calls them "ego trips"—became black holes for money. Even after the bubble burst, NASDAQ kept investing overseas. In March, 2001, it bought majority control of NASDAQ Europe for $12 million, on top of its earlier $25 million stake. NASDAQ Japan, which never took off, was even costlier, reporting cumulative losses of $88 million from 2000 to 2002.

Cover Story

When Zarb retired in 2001, Hardwick Simmons, a former Prudential Securities CEO, was hired to carry out the strategy. When it became clear that the ECNs were eating NASDAQ alive, the market hatched SuperMontage as the killer app to restore its supremacy. The ECNs were furious and hit back. They claimed NASDAQ could use SuperMontage—along with its links with NASD, their regulator—to gain unfair advantages. Their complaints to the SEC, echoed by friendly lawmakers on Capitol Hill, delayed the new system for two years and forced NASDAQ to make compromises. NASD, for example, agreed not to require dealers and ECNs to post their quotes on SuperMontage.

While NASDAQ haggled with the SEC, competition among the ECNs turned brutal, slashing more than a dozen players down to six major firms. So by the time SuperMontage finally launched last October, "[NASDAQ] hopped into a shark tank with some pretty hungry sharks," says Gerald D. Putnam, CEO of Archipelago, one of the largest ECNs.

Instead of being the hunter, NASDAQ turned out to be the prey. Its system lacked many of the gee-whiz features that attract big institutions to ECNs. Large traders don't dare advertise they want to buy, 100,000 shares of for fear other pla will bid the stock ECNs allow trade trickle out orders out revealing thei hand. To avoid ar ing the market-ma SuperMontage lef such features. Putnam: "Super tage was antiqu from the day it out."

SuperMontage f to halt the slide in DAQ's share of tra its own stocks, Simmons didn't res to shrinking reve quickly. Hellman— became a directo 2001 when his Francisco firm NASDAQ $240 millio buy back its shar and his fellow b members steppe Simmons left, and feld came on bo The incumbent agement's choice CEO, President Ric G. Ketchum, depa to become gen counsel of Citigroup's investment-banking unit. Also o short order: Steven Dean Furbush, an executive vice-p dent who oversaw the main trading business, and Willia Harts, director of strategy. Simmons says his plan w have worked if stocks had stabilized in 2002. "We made I thought were the right decisions," Simmons says. Harts clined to comment on the record. Ketchum and Furbush not return several calls.

MONEY ON THE LINE

Hellman, whose firm lent NASDAQ $240 million, worked to install Greifeld as the new CEO

Greifeld brings a nose-to-the-grindstone ethic to NAS which long behaved as a complacent bureaucracy. And he the outsider's ability—and the board's mandate—to slash penses. He has cut about 80 staff and chopped five non products. Former NASDAQ officials say most of the downs so far was already in the works, and Greifeld will need t much further—cutting payroll by an additional 300 staffe to bring NASDAQ's costs in line with those of the lean E For now, the board seems elated with Greifeld: "Bob is actly what we hoped he would be—a no-nonsense mana says Hellman.

Greifeld realizes that NASDAQ can't cut its way bac prosperity. His first challenge is to recapture institut business from the ECNs. Soon, dealers and brokers wi able to post anonymous quotes on SuperMontage. there's a catch: Traditional NASDAQ market-makers plain bitterly that by improving SuperMontage, NASD cutting them out of the picture. "Market-makers can't t NASDAQ," gripes Arthur J. Pacheco, senior managing dir at Bear, Stearns & Co. "Do they intend to be in di competition with us?"

en with a larger share of trading, NASDAQ will spiral ward if it doesn't reverse its decline in listings. So ld plans to go toe-to-toe with the NYSE. In marketing igns and personal visits to CEOs, he will argue that NAS- the better place to list. It set up a Market Intelligence to alert companies of unusual trading activity in their s. But few industry mavens think Greifeld can win a nged shootout with NYSE Chairman Richard A. Grasso. Bernard L. Madoff, a former NASDAQ chairman whose Bernard L. Madoff Investment Securities LLC, does 10% of NYSE trades: "Take it from me, as someone been competing against New York for 40 years, NASDAQ ave a tough time."

SDAQ does have some ammunition. Since the price-fixing al, trade execution on NASDAQ has improved immensely. d, some institutional traders say ow prefer trading NASDAQ stocks he Big Board's. "I'd much rather Microsoft [on NASDAQ] than IBM e NYSE] because trading a NAS- tock is that much easier," says A. Stark, director of trading at York money-management firm Capital Management. eifeld could try to narket share by ac- g an ECN. "Acquisi- are certainly some- we should be ng about, no denying he says. In one he could nearly dou- perMontage's share ding and radically de NASDAQ's techno- underpinnings. Pri- held Archipelago be the most allur- since it merged with Pacific exchange in it has had the exchange license NASDAQ so ardently desires. In ASDAQ has flirted with Archipel- efore. A source close to both mar- ays the two discussed a merger this year but couldn't agree on a Former NASDAQ execs also say m and Greifeld didn't hit it off. tinet, 63% owned by Reuters, is rnative. It executes about 28% of Q trades, vs. Archipelago's 15%. et CEO Edward J. Nicoll is now g Instinet's trading business to land subsidiary—potentially set- p a sale of the trading system, in- sources say. But Instinet, with a t cap of $1.6 billion, wouldn't cheap. The enlarged Island could $750 million—a hefty chunk of e for NASDAQ—says Benn Steil, pert on global stock exchanges enior fellow at the Council on gn Relations.

any case, an acquisition won't ntee NASDAQ the exchange status reedom it craves. The SEC would have to approve any transfer of Archipelago's license. Since the Pacific exchange has price-time priority, adopting that would likely be a condition for NASDAQ to buy Archipelago.

How did NASDAQ get into this corner, where every strategy seems to force a choice between its independence and its dominant market-makers? Counselor Knight gripes that the SEC led NASDAQ on by approving its private issuance of shares in 2001. "Those shares were premised on us becoming an exchange," he says. Not so, say SEC officials. "They jumped the gun," says Nazareth. "We could not have anticipated all of the details of their application. They should've waited for the exchange application to be approved."

Why didn't they? "They were pursuing the riches of the Internet bubble," says Instinet's Nicoll. Some former NASDAQ officials think stock options were the lure. "It was an attempt to become a real company," says one, "but you could say a major motivation was to get stock options." Zarb, who received 2 million options over two years, says that idea is "ridiculous." The market issued shares to gain "an equity base so NASDAQ could separate from its regulator [NASD] and support itself."

That separation now looks like a distant dream. A financial crunch looms as NASDAQ figures out how to repay its venture backers. Some industry players and SEC officials think that has made NASDAQ more attuned to Hellman's interests than to its own constituencies. "Clearly, it's dominated by the venture capitalists now," says Madoff. A former top NASDAQ exec agrees: "At this point, Bob Greifeld's job is to dress up NASDAQ long enough for Warren Hellman to get his $240 million back." Greifeld says only: "I am here to protect and grow our shareholders' interests."

In the long term, NASDAQ could struggle to remain just a player, let alone become the world-beater it once was. It has long odds of winning exchange status from the SEC. And despite its for-profit status, it will have a tough time raising the capital it needs as long as it's tethered to NASD. Owned by a stodgy regulator, NASDAQ remains flat-footed and ill-equipped for the cut-throat competition that's taking over markets worldwide. It will have to make far more painful cuts to payroll and operations to joust with the lean-and-mean ECNs. And its quest to lure companies away from the NYSE is a long shot.

Even if it cannot break free, NASDAQ won't disappear overnight. The screens will still flash on Times Square, and for many, NASDAQ will still evoke the glamour of high tech and go-go growth. But those technicolor panels already seem a facade for a shrunken market. The trading venue that once called itself the stock market for the next 100 years could become a mere shadow of what it was in the last decade. ■

ROBERT GREIFELD

BORN Queens, N.Y., July 18, 1957. Raised on Long Island.

CURRENT POSITION President and CEO, NASDAQ.

COLLEGE SWEETHEARTS

EDUCATION BA in English, Iona College, 1979. MBA, NYU's Stern School of Business, 1986, where his thesis was on how automation could affect NASDAQ.

CAREER PATH Joined Burroughs Corp. in 1979 as a sales trainee, rising to district manager for New York City and Long Island. Joined Automated Securities Clearance in 1991, where he built the BRASS order-management system for stocks into a must-have for traders. Oversaw development of BRUT, an ECN. When SunGard Data Systems bought ASC in 1999, he became executive vice-president of its brokerage-systems division.

HOW HE LEARNED TRADING When BRASS was just getting started, he spent a year haunting Wall Street's trading desks.

FAMILY He and his wife, Julia, were college sweethearts. He delivered FedEx packages weekends to earn money to buy her engagement ring. They live with their two sons, ages 16 and 14, and daughter, 10, in Westfield, N.J.

Data: *BusinessWeek*

'THE FOG IS BEGINNING TO LIFT'

With the economy's biggest worries behind it, earnings look set to keep heading up

The recovery in corporate profits keeps chugging along. While the second quarter opened inauspiciously with the U.S. at war, that didn't slow the momentum of improving earnings. Profits for the 900 companies on *BusinessWeek*'s Corporate Scoreboard jumped 31%, a second straight quarter of double-digit gains. Almost half of that came from a huge rebound by Lucent Technologies Inc. Still, sales grew 6%, vs. the tepid 1% turned in a year ago.

Even better, some of the economy's most nettlesome worries are behind it, which should help keep profits moving northward. There are far fewer of the billion-dollar-plus write-offs that depressed earnings last year. The spring saw the quick end of major combat in Iraq, while the threat of a widesp SARS epidemic abated. Demand for goods and services improved, g companies a chance to crank up fac and occasionally raise prices. The r Profit margins rose to 6.4%, more t full percentage point higher tha year before. Throw in the declinin lar, which boosted the value of generated abroad, and by July 25.

Winners and Losers in Quarterly Profits

INDUSTRIES

LEADERS	PERCENT CHANGE FROM 2002's SECOND QUARTER
INTERNET SOFTWARE & SVCS.	992%
DIVERSIFIED TELECOM SVCS.	594
COMPUTERS & PERIPHERALS	217
DIVERSIFIED FINANCIAL SVCS.	207
BIOTECHNOLOGY	172
CHEMICALS	122
OIL & GAS	81
PAPER & FOREST PRODUCTS	80
MEDIA	64
CONSUMER FINANCE	53
INSURANCE	39
MACHINERY	33
SOFTWARE	32
MULTI-UTILITIES	30
HOUSEHOLD DURABLES	24

LAGGARDS	PERCENT CHANGE FROM 2002's SECOND QUARTER
ELECTRONIC EQUIPMENT	LOSS
SEMICONDUCTORS	LOSS
PHARMACEUTICALS	–71%
OFFICE ELECTRONICS	–58
METALS & MINING	–52
CONSTRUCTION MATERIALS	–44
AEROSPACE & DEFENSE	–43
AUTO COMPONENTS	–42
CONSTRUCTION & ENG.	–34
LEISURE EQUIPMENT & PRODS.	–28
AUTOMOBILES	–26
ELECTRIC UTILITIES	–17
REAL ESTATE	–13
IT SERVICES	–13
INDUSTRIAL CONGLOMERATES	–10

ALL-INDUSTRY AVERAGE: 31%

COMPANIES

WHO MADE THE MOST	MILLIONS OF DOLLARS
CITIGROUP	$4,299
GENERAL ELECTRIC	3,794
BANK OF AMERICA	2,738
ALTRIA GROUP	2,437
AMERICAN INTL. GROUP	2,277
MICROSOFT ***	1,921
MERCK	1,867
WAL-MART STORES *	1,830
J.P. MORGAN CHASE	1,827
IBM	1,725
WELLS FARGO	1,525
SBC COMMUNICATIONS	1,388
COCA-COLA	1,362
VERIZON COMMUNICATIONS	1,233
JOHNSON & JOHNSON	1,210

WHO LOST THE MOST	MILLIONS DOLLA
PFIZER	–$3,6
SOLECTRON **	–3,1
KMART HOLDING *	–8
BROADCOM	–8
LEVEL 3 COMMUNICATIONS	–4
LUCENT TECHNOLOGIES **	–2
MICRON TECHNOLOGY **	–2
BOEING	–1
VISTEON	–1
LSI LOGIC	–1
AGILENT TECHNOLOGIES	–1
BROCADE COMMUNICATIONS	–1
ADVANCED MICRO DEVICES	–1
METRO-GOLDWYN-MAYER	–1
TELLABS	–1

*FISCAL FIRST QUARTER **FISCAL THIRD QUARTER ***FISCAL FOURTH QUARTER

Data: Standard & Poor's COM

of companies reporting earnings to son First Call had exceeded Wall 's expectations. "The fog is begino lift," says Richard D. Rippe, chief mist at Prudential Securities Inc. uld the second phase of the recovat has eluded the economy two running be upon us? Economists vestors who doubted it just six s ago are now voicing a full-throat-. They say improving profits fore-w a stronger economy, which will, n, be even better for profits. In- rates are low, some companies osting capital spending, and proity is rising. With companies runean, "even a modest improvement owth is likely to drop straight h to the bottom line," says Stuart weitzer, global investment strate- J.P. Morgan Fleming Asset Manent. Moreover, Federal Reserve nan Alan Greenspan expects tax o pump $35 billion into the econothe third quarter. The consensus that gross domestic product will at a 3.7% annual rate in the second f 2003, up from a sluggish 1.5% te in the first half.

be sure, not every company will t from the good news. Already, 341 U.S. companies that reported gs as of July 25, says First Call, d of earnings misses in the third r. Many hotel, airline, and capital- companies are likely to remain Unemployment, at a nine-year of 6.4% in June, could still rise. of terrorist attacks could revive a crimp in spending, and energy haven't dropped much from their r runup (page 74). Overall, though, eelings abound. Since early March, tock market, a leading indicator, llied, with the Dow Jones indusverage surging 22%.

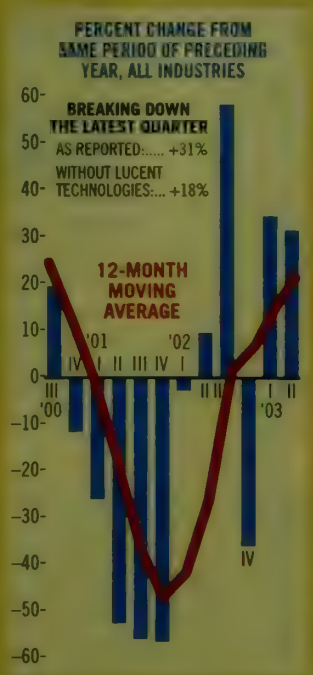
e of the big positives in this quarresults is the upturn in the tech- industry. While no one is quite ady to declare a full-blown recovemand for computers is slowly rising, and the giants of the industry are getting higher prices for their snazziest new offerings. At IBM, second-quarter earnings shot up 288%, to $1.7 billion. The year before, IBM earned only $445 million, as its bottom line was crushed by write-offs and restructuring charges. Chief Financial Officer John R. Joyce says the uptick is just the beginning: "We can and will do better as the second half evolves." IBM credits gains from its acquisitions of PricewaterhouseCoopers Consulting and Rational Software Corp., which broadened IBM's reach in high-margin businesses.

In the quarter, Intel Corp. shipped 1 million of its new Centrino chips, which link notebook computers to wireless networks. That helped earnings to more than double, to $896 million, Intel's best year-over-year showing since the third quarter of 2000. Microsoft Corp., meanwhile, boosted profits 26%, to $1.9 billion, thanks to strong sales of a new operating system for servers.

Even telecom companies, once the economy's leakiest boats, are finding safe harbor, thanks to continued cost-cutting and big gains in wireless, broadband, and long distance. BellSouth Corp.'s earnings rose 262%, to $951 million, after the company added 540,000 wireless and 856,000 long-distance customers—far more than anticipated. And both Lucent and Motorola Inc. bounced back from ugly losses the previous year. Lucent trimmed its $8 billion loss to $254 million, while Motorola turned a $2.3 billion loss into earnings of $119 million. "The telecom recession has run

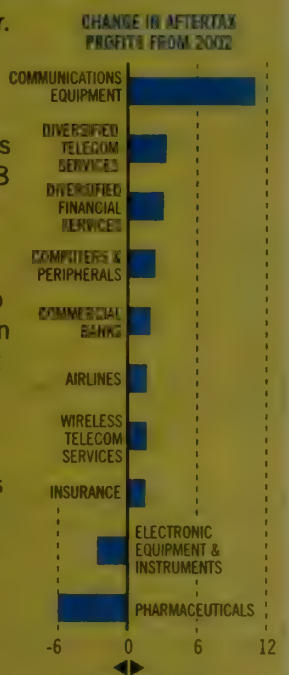
Spotlight On Second Quarter Profits

AFTERTAX PROFITS QUARTER BY QUARTER



INDUSTRIES WITH THE BIGGEST DOLLAR CHANGE IN THE QUARTER

Another good, not great, quarter. Revenues increased by 6%, while earnings bounced up 31%. But over 40% of that came from Lucent Technologies rebounding from last year's $8 billion loss. There were other special cases: Most of the improvement in financial services came from CIT Group coming back from a $2.4 billion loss, while IBM's 288% profit jump provided much of the bounce for computer makers. But Solectron did in the electronics equipment makers by posting a $3.1 billion loss. So consistency appears to be lacking in corporate profits, although a jagged recovery is better than no recovery at all.



Data: Standard & Poor's COMPUSTAT

its course," says Susan Kalla of Friedman, Billings, Ramsey Group Inc.

With market prospects improving, the financial industry continues to post solid gains. Citigroup's profits rose 12%, to $4.3 billion, the largest total for all companies. Bank of America and Wachovia posted 20%-plus growth. Surging trading volume and higher levels of debt issuance helped offset the dearth of underwriting and merger business. "Fixed income has just been roaring for us, and we're starting to see a comeback in equities," says Robert B. Willumstad, Citigroup president. Profits at rival J.P. Morgan Chase & Co. rose 78%, to $1.8 billion, the first time earnings rose in back-to-back quarters since Chase Manhattan and J.P. Morgan merged in 2000.

So where does the optimism about profits stop? In the car business, for one. Sales at General Motors Corp. were flat, year to year, while profits fell 30%, to $901 million, and most of that came from lending operations, not car sales. Meanwhile, Ford Motor Co. suffered a 31% profit decline, to $425 millio heavy incentives ate into earn Drugmakers also got hit hard. wether Pfizer Inc. lost $3.7 billion, ly because of a $5.9 billion aftertax cash charge related to accountin the Pharmacia Corp. acquisition, Johnson & Johnson's earnings fell to $1.2 billion, also hurt by acqui costs. Even mighty General Electr saw profits fall 14%; its power-sy unit, for one, suffered in the dow

But the economy is likely to g steam in the months ahead. And does, Corporate America should s profits energized once again.

By Andrew Park in Dallas, Mara Der Hovanesian in New and bureau reports

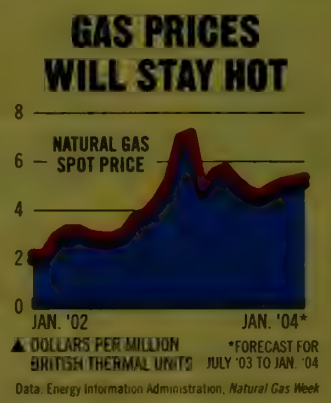
HIGH ANXIETY OVER HIGH ENERGY

Winter is long gone, and major hostilities in Iraq officially ended in May. Yet energy prices in the U.S. haven't fallen back as much as expected. Natural gas and oil are still pricey—and appear likely to take a big bite out of profits in some industries for months to come.

In July, Federal Reserve Chairman Alan Greenspan said that high natural gas prices are putting big consumers like chemical, metals, and paper companies in "a weakened competitive position." The current price near $4.70 per million Btus is up more than 50% from a year ago. Oil is down from a war-induced runup but is still near $30 per barrel, far above the 10-year average of $21. The big reason: Fighting isn't completely over in Iraq, and looting and sabotage continue to disrupt rebuilding. "Exports from Iraq are way behind what any plans or schedules were," says Dennis Eklof, executive managing director for the Global Energy Service at Global Insight Inc.

There isn't much price relief in sight. The Energy Information Administration expects natural gas to stay near $5 per million Btus for this year. Andrew D. Weissman, chairman of Energy Ventures Group, believes a cold winter could drive prices up to $10 per million Btus. Plus, U.S. oil inventories are low: Companies keep holding off restocking in the hope prices will drop. Another disruption like the strike in Venezuela or conflict in Nigeria earlier this year could cause oil to shoot up.

Some sectors are really getting burned. For fertilizer maker IMC Global Inc., not only are natural gas prices up but ammonia, a key ingredient made from gas, has climbed more than 60% from a year ago. IMC recently locked in 55% of its gas needs for the rest of the year at $4.48 per million Btus. But its business model is built on gas at close to $4 per million Btus. Through June, AK Steel shelled out $40 million more to fuel its plants than it did the previous year. That contributed to a $78.2 million loss last quarter, compared with the year-earlier $16.2 million profit. And at Northwest Airlines, fuel costs rose faster than any expense except depreciation and amortization last quarter. Northwest lost $160 million, not counting federal security payments, the sale of a reservations system, and other special items.



The other side of the coin, of course, is that bottom lines will continue to fatten at energy-exploration and -production companies. Electric utilities that have electricity to spare could also benefit. If the mild summer turns hot, electric companies that own a lot of newer gas-fired power plants may find it cheaper to buy electricity from another utility than to increase output at their ow facilities.

The oil market is skeptical of U. government claims that significant Iraqi production will come by August. But once oil does start really flowing, prices should drop. Natura gas is another story, though. North American supplies are fading, even as more homes use the clean-burni fuel for heating and utilities ramp up ca pacity with gas-fire power plants. Gas producers are build ing rigs and increas ing their ability to import liquid natur gas (LNG). Even so, new supplies are barely offsetting eroding output from older fields. LNG co cover only 10% of U.S. demand by 20 says Paul Horsnell, head of energy research at J.P. Morgan Chase &

The few major gas users that ca switch to another energy source must decide if a move is feasible fi nancially and environmentally. If they can't? Says Horsnell: "The choices are starker: Absorb the hig er costs, relocate to another countr or close down completely." For son companies, the natural gas dilemm is really heating up.

By James Mehring in New York with Michael Arndt in Chicago

Second Quarter 2003

CORPORATE SCOREBOARD

ssary

s: Includes all sales and operating revenues. For s, includes all operating ues.

rts: Net income before ordinary items. For banks, profits are net income after security gains or losses.

MARGINS: Net income from continuing operations before extraordinary items as percent of sales.

RETURN ON COMMON EQUITY: Ratio of net income available for common stockholders (most recent 12 months) to latest available common equity, which includes common stock, capital surplus, and retained earnings.

PRICE-EARNINGS RATIO: Based on July 24, 2003, common-stock price and corporate earnings from continuing operations before extraordinary items for most recent 12-month period.

EARNINGS PER SHARE: For most recent 12-month period. Includes all common-stock equivalents.

PANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY		
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	PRICE–EARNINGS RATIO 7-24	12 MONTHS' EARNINGS PER SHARE
INDUSTRY COMPOSITE	**1464212.9**	**6**	**2909715.6**	**7**	**93064.6**	**31**	**190319.5**	**30**	**6.4**	**5.2**	**10.9**	**29**	**1.07**
SUMER DISCRETIONARY SECTOR													
R COMPOSITE	358865.2	3	733814.6	4	12133.9	8	26022.5	37	3.4	3.2	0.6	NM	0.05
AUTOMOBILES & COMPONENTS													
STRY GROUP COMPOSITE	124948.1	0	250000.3	3	2086.7	–31	5259.1	60	1.7	2.4	16.3	13	1.50
UTO COMPONENTS													
STRY COMPOSITE	33664.6	3	66341.1	6	528.7	–42	1100.9	25	1.6	2.8	11.3	15	1.36
ICAN AXLE & MFG. HOLDINGS AXL	913.6	4	1088.9	9	51.0	5	105.0	20	5.6	5.5	23.3	8	3.69
MERITOR ARM (3)	2109.0	12	4102.0	15	47.0	–24	71.0	–27	2.2	3.3	13.8	9	2.13
LIV ALV	1366.5	17	2612.2	19	71.2	36	122.7	34	5.2	4.5	9.7	13	2.19
AG BDG	204.1	–12	379.4	–10	8.7	–26	11.1	–14	4.3	5.0	11.0	15	2.50
WARNER BWA	769.5	8	1545.2	15	44.8	–2	89.0	15	5.8	6.4	14.5	11	6.00
E TIRE & RUBBER GTB	839.6	0	1634.4	–1	12.7	–67	27.9	–57	1.5	4.7	7.6	16	1.01
DCN	2581.0**	–3	5053.0	1	55.0	–5	101.0	124	2.1	2.2	6.7	20	0.77
HI DPH	7094.0	–3	14276.0	2	88.0	–60	215.0	27	1.2	3.0	23.5	12	0.70
STEMMERZ INTERNATIONAL HAYZ (11)	515.3	5	990.8	4	–22.6	NM	–45.4	NM	NM	NM	NM	NM	–2.44
RMET INMT	196.8	–10	403.9	–5	–6.6	NM	–3.4	NM	NM	2.2	–1.6	NM	–0.15
SON CONTROLS JCI (3)	5959.9	13	11463.0	14	190.0	8	322.2	11	3.2	3.3	10.0	14	6.90
LEA	4101.2	8	7999.9	9	104.1	22	172.0	30	2.5	2.3	18.4	10	5.22
NE MFG. MODI (9)	288.9	5	561.5	7	11.3	9	19.4	26	3.9	3.8	6.3	19	1.05
H INDUSTRIES SHLO (2)	160.3	1	296.9	–3	1.8	NM	1.4	NM	1.1	NM	–16.6	NM	–1.21
RIOR INDUSTRIES INTERNATIONAL SUP	210.8	–1	422.3	6	17.7	–16	39.9	5	8.4	9.9	14.2	14	2.97
ECO AUTOMOTIVE TEN	998.0	5	1919.0	9	24.0	26	25.0	47	2.4	2.0	650.0	6	0.94
R AUTOMOTIVE TWR	743.2	–1	1475.8	4	–2.4	NM	9.1	NM	NM	3.0	6.9	7	0.64
ON VC	4613.0	–8	9317.0	–2	–167.0	NM	–182.0	NM	NM	1.4	–9.3	NM	–2.12
UTOMOBILES													
STRY COMPOSITE	91283.5	–2	183659.1	2	1558.0	–26	4158.2	74	1.7	2.3	20.7	13	1.59
MOTOR F	40804.0	–4	81840.0	0	425.0	–31	1324.0	146	1.0	1.5	13.1	20	0.53
RAL MOTORS GM	48308.0**	0	97673.0	8	901.0	–30	2384.0	57	1.9	2.7	25.0	8	4.58
EY-DAVIDSON HDI	1290.2**	22	2474.6	22	202.2	40	388.4	47	15.7	13.6	27.7	20	2.30
CO COACH MHC	268.4	–14	541.9	–11	0.6	–95	4.9	–76	0.2	3.5	10.8	15	0.98
INDUSTRIES THO (5)	412.7	12	742.6	17	20.2	21	35.5	46	4.9	4.5	19.6	16	2.67
EBAGO INDUSTRIES WGO (4)	200.2	–19	386.9	–10	9.0	–49	21.3	–21	4.5	7.2	26.7	14	2.80
ONSUMER DURABLES & APPAREL													
STRY GROUP COMPOSITE	44752.1	9	84890.7	10	2381.1	11	4218.6	19	5.3	5.3	18.5	14	2.41
OUSEHOLD DURABLES													
STRY COMPOSITE	29011.5	11	55249.5	12	1649.6	24	3022.9	25	5.7	5.1	19.8	12	3.38
ICAN GREETINGS AM (10)	454.3	–6	980.2	–6	19.7	–56	65.1	107	4.3	9.2	8.6	14	1.25
ER HOMES USA BZH (3)	771.8	4	1437.3	15	40.7	17	78.7	34	5.3	4.7	16.9	7	11.62
K & DECKER BDK	1119.7	0	2087.9	1	75.7	15	119.1	20	6.8	5.9	38.4	13	3.14
H BTH (11)	312.0	12	692.5	8	19.6	13	42.6	38	6.3	6.2	16.7	13	1.97
EX CTX (8)	2316.7**	28	5201.5	28	142.3	53	339.0	66	6.1	4.8	22.2	8	9.67

ond quarter ended May 31. (2) Second quarter ended Apr. 30. (3) Third quarter and most recent six months ended June 30. (4) Third quarter and most recent six months ended May 31. (5) Third quarter and cent six months ended Apr. 30. (6) Fourth quarter and most recent six months ended June 30. (7) Fourth quarter and most recent six months ended May 31. (8) Fourth quarter and most recent six months Apr. 30. (9) First quarter and most recent six months ended June 30. (10) First quarter and most recent six months ended May 31. (11) First quarter and most recent six months ended Apr. 30. *Sales include axes. **Sales include other income. ***Sales include excise taxes and other income. †Revenues from major subsidiaries not included in consolidated sales. Earnings per share are for latest 12 months, not nec- for end of most recent fiscal year; they include all common-stock equivalents but exclude extraordinary items. NA = not available. NM = not meaningful.

Data: Standard & Poor's COMPUSTAT

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY		
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6.30	PRICE–EARNINGS RATIO 7-24	
CHAMPION ENTERPRISES CHB	296.1	–18	540.6	–19	3.0	NM	–18.4	NM	1.0	NM	NM	NM	
FLEETWOOD ENTERPRISES FLE [8]	572.7	–5	1065.9	–5	–55.4	NM	–73.8	NM	NM	NM	–63.7	NM	
FORTUNE BRANDS FO	1510.8	5	2832.4	5	178.7	–10	276.2	–2	11.7	13.7	22.6	16	
FURNITURE BRANDS INTERNATIONAL FBN	579.6	–4	1193.5	–4	23.6	–27	52.6	–19	4.1	5.3	11.5	13	
HORTON (D.R.) DHI [3]	2212.4	22	4120.9	21	155.6	47	283.4	45	7.0	5.9	18.5	8	
HOVNANIAN ENTERPRISES HOV [2]	679.8**	21	1307.5	19	52.6	103	97.3	121	7.7	4.6	29.1	9	
KB HOME KBH [1]	1440.1	26	2535.1	23	81.4	27	134.2	26	5.7	5.6	24.7	7	
LA-Z-BOY LZB [8]	540.3	–9	1050.9	–8	25.1	1	48.3	4	4.6	4.2	15.5	13	
LEGGETT & PLATT LEG	1052.7	–6	2090.3	–2	46.7	–34	96.1	–24	4.4	6.3	9.9	21	
LENNAR LEN [1]	2109.9**	35	3718.1	32	160.3	51	266.6	50	7.6	5.6	25.3	8	
LIBBEY LBY	128.9	12	241.5	13	7.9	61	9.9	12	6.1	4.3	25.2	14	
M.D.C. HOLDINGS MDC	689.2	35	1258.7	30	42.7	24	79.7	20	6.2	6.7	22.1	8	
MAYTAG MYG	1162.9	–3	2298.9	–3	25.5	–63	60.1	–52	2.2	5.7	140.4	16	
MERITAGE MTH	333.8**	33	617.2	47	21.3	43	37.1	58	6.4	5.9	23.9	8	
MOHAWK INDUSTRIES MHK	1247.2	2	2331.9	11	75.0	–1	116.6	–2	6.0	6.2	13.6	16	
NVR NVR	848.5**	8	1592.1	6	95.1	13	182.9	14	11.2	10.6	23.6	10	
PALM HARBOR HOMES PHHM [9]	155.9	13	292.0	12	0.8	NM	1.0	93	0.5	NM	2.0	71	
PULTE HOMES PHM	1958.2	16	3510.8	15	122.0	35	208.3	31	6.2	5.4	16.6	8	
RYLAND GROUP RYL	840.0	24	1499.7	23	54.0	21	92.2	30	6.4	6.6	28.0	9	
SNAP-ON SNA	576.4**	4	1130.0	5	22.3	–24	43.7	–14	3.9	5.3	10.4	17	
STANLEY WORKS SWK	699.7	8	1365.9	8	12.4	–80	31.6	–72	1.8	9.8	13.4	24	
TOLL BROTHERS TOL [2]	608.0**	11	1178.0	13	52.9	1	98.3	1	8.7	9.6	18.2	9	
TORO TTC [2]	495.8**	5	791.8	6	42.0	10	49.0	48	8.5	8.1	18.1	14	
TUPPERWARE TUP	310.0	8	581.5	8	14.1	–56	20.5	–57	4.5	11.2	31.0	14	
WHIRLPOOL WHR	2988.0	8	5705.0	7	94.0	49	185.0	25	3.1	2.3	30.1	15	
(B) LEISURE EQUIPMENT & PRODUCTS													
INDUSTRY COMPOSITE	7355.3	3	13446.2	3	319.5	–28	418.1	–22	4.3	6.2	17.2	17	
BRUNSWICK BC	1071.0	5	2005.5	6	53.6	16	57.4	–3	5.0	4.5	8.6	24	
CALLAWAY GOLF ELY	242.1	–4	513.8	1	34.1	–8	76.6	13	14.1	14.7	12.7	13	
EASTMAN KODAK EK	3352.0	0	6092.0	1	112.0	–61	109.0	–67	3.3	8.6	20.2	13	
HASBRO HAS	581.5	6	1043.2	6	11.4	NM	12.6	NM	2.0	NM	10.0	25	
K2 KTO	199.7	27	356.8	17	5.8	80	5.9	–23	2.9	2.4	3.2	31	
MARINEMAX HZO [3]	187.2	10	346.2	14	8.5	10	12.5	14	4.5	4.5	11.6	12	
MATTEL MAT	769.0	–4	1514.3	–2	20.9	7	53.7	244	2.7	2.4	23.6	18	
OAKLEY OO	143.8	–1	255.0	0	18.2	–18	21.4	–23	12.7	15.4	11.6	21	
POLARIS INDUSTRIES PII	377.1	4	691.1	4	21.0	6	33.4	6	5.6	5.5	41.9	17	
SCP POOL POOL	431.9	19	628.3	17	34.0	19	35.4	16	7.9	7.9	25.3	20	
(C) TEXTILES, APPAREL & LUXURY GOODS													
INDUSTRY COMPOSITE	8385.4	6	16195.0	6	412.0	9	777.6	33	4.9	4.9	15.8	17	
BROWN SHOE BWS [11]	446.4	0	896.6	4	9.0	18	18.4	NM	2.0	1.7	15.1	11	
COLUMBIA SPORTSWEAR COLM	152.1	22	320.9	20	9.4	25	24.4	46	6.2	6.1	21.2	19	
HARTMARX HMX [1]	127.0**	–3	258.8	–4	1.0	NM	2.1	NM	0.8	NM	4.1	14	
KELLWOOD KWD [11]	689.2	21	1226.5	18	20.8	144	29.3	442	3.0	1.5	9.2	16	
NAUTICA ENTERPRISES NAUT [10]	139.2	11	317.7	12	–1.6	NM	4.0	NM	NM	NM	6.3	27	
NIKE NKE [7]	2985.1	11	5386.0	9	246.2	18	370.9	11	8.2	7.8	18.5	19	
OXFORD INDUSTRIES OXM [7]	198.1	3	407.0	19	4.6	–18	11.6	85	2.3	2.9	10.7	18	
PHILLIPS-VAN HEUSEN PVH [11]	377.0	6	692.3	5	–2.2	NM	3.6	NM	NM	NM	8.4	16	
QUIKSILVER ZQK [2]	262.2	40	454.3	36	22.6	68	29.2	76	8.6	7.2	12.7	18	
REEBOK INTERNATIONAL RBK	802.6	12	1600.9	10	25.6	4	66.4	8	3.2	3.4	14.7	16	
SAMSONITE SAMC [11]	161.9	1	356.4	14	–4.0	NM	4.9	NM	NM	NM	NM	NM	
STRIDE RITE SRR [1]	154.3	–1	306.6	3	11.2	–3	20.0	5	7.3	7.4	9.3	15	
TIMBERLAND TBL	211.7	11	482.7	15	5.8	18	25.1	61	2.7	2.6	27.7	17	
UNIFI UFI [6]	206.1	–20	425.7	–9	–30.5	NM	–29.3	NM	NM	NM	–5.7	NM	
UNIFIRST UNF [4]	153.7	7	300.1	1	9.6	23	13.4	5	6.3	5.2	8.7	17	
VF VFC	1134.7**	–2	2384.8	1	74.9	–15	167.0	1	6.6	7.6	20.7	11	
WOLVERINE WORLD WIDE WWW	184.0	9	375.5	6	9.3	2	16.7	8	5.0	5.4	12.9	16	
3 HOTELS RESTAURANTS & LEISURE													
INDUSTRY GROUP COMPOSITE	19322.5	2	37157.4	2	1346.8	–8	2228.0	–6	7.0	9.2	10.9	23	
AMERICAN SKIING AESK [5]	127.7	–3	228.0	–2	22.5	–9	15.1	NM	17.6	18.7	NM	NM	
AZTAR AZR	214.5	2	417.5	0	18.8	14	32.3	7	8.8	7.8	11.7	11	
BOB EVANS FARMS BOBE [8]	265.5	2	536.7	3	17.6	1	34.4	2	6.6	6.7	13.4	13	
CARNIVAL CCL [1]	1334.6	35	2365.7	25	127.8	–34	254.7	–21	9.6	19.6	7.3	21	
CBRL GROUP CBRL [5]	527.2	4	1090.3	6	23.4	14	48.0	15	4.4	4.1	12.9	18	
CEC ENTERTAINMENT CEC	152.9	7	337.0	7	14.8	–4	42.2	0	9.7	10.8	14.8	14	
CHEESECAKE FACTORY CAKE	188.6	14	361.5	15	15.3	15	27.9	17	8.1	8.0	12.8	31	
CHURCHILL DOWNS CHDN	180.5	5	214.3	5	25.0	21	16.5	49	15.5	13.4	10.5	18	
CKE RESTAURANTS CKR [11]	419.6	–1	718.2	–1	–3.7	NM	–11.9	NM	NM	3.1	4.8	40	
DARDEN RESTAURANTS DRI [7]	1227.5	6	2408.9	5	61.1	–16	122.9	–12	5.0	6.3	10.4	15	

PORATE SCOREBOARD

PANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY		
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	PRICE–EARNINGS RATIO 7-24	12 MONTHS' EARNINGS PER SHARE
H HOLDINGS GTK [10]	239.6	4	509.5	1	41.0	41	83.0	109	17.1	12.5	40.9	15	2.63
AH'S ENTERTAINMENT HET	1080.2	7	2139.1	8	77.9	–8	158.2	–7	7.2	8.4	20.1	15	2.81
NATIONAL GAME TECHNOLOGY IGT [3]	597.7	16	1165.3	15	103.0	29	196.1	29	17.2	15.5	22.4	27	0.99
F CAPRI CASINOS ISLE [8]	275.9	–8	529.0	–6	18.2	NM	26.6	NM	6.6	NM	22.4	11	1.50
Y KREME DOUGHNUTS KKD [11]	148.7	34	285.4	25	13.1	48	18.8	10	8.8	8.0	11.3	58	0.63
STAR STEAKHOUSE & SALOON STAR	143.7	3	288.2	0	7.1	14	15.8	–16	4.9	4.5	13.5	14	1.51
ALAY RESORT GROUP MBG [11] †	616.5	1	1160.7	3	44.0	–13	48.2	NM	7.1	8.3	13.4	20	1.63
OTT INTERNATIONAL MAR	2038.0	0	4052.0	5	126.0	–1	213.0	2	6.2	6.2	12.0	22	1.80
MIRAGE MGG	985.3	1	1945.6	1	55.9	–44	105.4	–42	5.7	10.3	8.0	25	1.37
CK STEAKHOUSE OSI	689.3	16	1340.9	14	47.1	11	92.2	10	6.8	7.1	15.7	17	2.17
HANG'S CHINA BISTRO PFCB	136.6	34	268.2	35	7.1	45	13.9	39	5.2	4.8	12.7	50	0.95
PLACE ENTERTAINMENT PPE	1187.0	0	2330.0	0	41.0	–57	82.0	–40	3.5	8.1	3.4	86	0.34
NATIONAL GAMING PENN	325.0	98	549.9	73	15.5	69	28.7	116	4.8	5.6	17.8	19	1.15
TUESDAY RI [7]	246.9	14	479.8	11	25.3	19	50.7	93	10.3	9.8	21.3	17	1.36
S FAMILY STEAK HOUSES RYAN	208.9	4	402.5	2	14.3	–7	26.4	–8	6.9	7.7	14.1	13	1.10
BUCKS SBUX [3]	1036.8	24	1991.0	23	68.4	23	120.5	36	6.6	6.7	13.6	41	0.65
OOD HOTELS & RESORTS HOT	1220.0	0	2313.0	0	87.0	14	–30.0	NM	7.1	6.2	2.5	59	0.52
ON CASINOS STN	210.0	6	409.6	5	20.6	159	33.2	58	9.8	4.0	15.1	41	0.70
P HOTELS & CASINO RESORTS DDT	306.9	0	585.7	–3	–10.0	NM	–34.0	NM	NM	0.1	–77.3	NM	–1.89
ESORTS MTN [5]	269.1	9	515.9	12	35.5	–25	52.3	–24	13.2	19.1	–1.4	NM	–0.22
Y'S INTERNATIONAL WEN	786.0	15	1480.0	14	61.1	–4	105.0	–2	7.8	9.3	13.7	15	1.87
BRANDS YUM	1936.0	10	3738.0	11	122.0	–13	240.0	–9	6.3	7.9	67.3	16	1.82
MEDIA													
STRY GROUP COMPOSITE	**30036.2**	**7**	**57539.4**	**7**	**2819.1**	**64**	**4422.7**	**71**	**9.4**	**6.1**	**–23.2**	**NM**	**–3.77**
AD [3]	289.7	3	576.8	4	13.6	34	24.5	32	4.7	3.6	77.8	19	2.34
ME WARNER AOL	10818.0	6	20816.0	6	1064.0	170	1460.0	278	9.8	3.9	–79.8	NM	–9.71
ONES DJ	393.6	–6	751.8	–7	30.8	–43	97.8	–47	7.8	12.9	200.1	30	1.41
S COMMUNICATIONS EMMS [10]	142.4	4	269.2	5	2.6	42	–2.6	NM	1.8	1.3	0.5	NM	0.07
TY NATIONAL INFO. SOLUTIONS FNIS	142.3	55	266.9	43	15.3	146	27.3	108	10.8	6.8	10.5	22	1.10
ETT GCI	1705.3	6	3257.5	4	324.3	7	574.1	5	19.0	18.8	16.8	17	4.40
IMAGES GYI	127.7	13	258.0	14	13.2	194	26.4	269	10.3	3.9	5.5	55	0.72
HANKS HHS	233.2	2	449.5	2	23.1	–4	39.5	–11	9.9	10.6	16.1	20	0.94
ES ELECTRONICS GMH	2370.7	8	4598.0	9	29.0	NM	–21.6	NM	1.2	NM	0.9	NM	0.03
T-RIDDER KRI	721.6	1	1399.0	0	77.2	1	127.9	–1	10.7	10.7	19.3	20	3.40
NTERPRISES LEE [3]	168.2	5	323.6	26	21.5	–29	36.1	–16	12.8	18.9	9.8	21	1.79
TCHY MNI	276.4	2	534.3	3	37.5	4	62.8	6	13.6	13.3	12.5	20	2.90
AW-HILL MHP	1190.5	1	2037.0	2	142.0	5	180.2	10	11.9	11.5	27.9	21	3.05
GENERAL MEG	211.9	8	409.4	1	17.5	8	24.5	10	8.3	7.7	5.2	24	2.39
GOLDWYN-MAYER MGM	487.7	45	882.9	35	–133.6	NM	–189.4	NM	NM	NM	–5.2	NM	–0.48
ORK TIMES NYT	801.9	4	1585.6	5	72.8	–8	141.7	6	9.1	10.2	24.2	23	1.99
MSAT SPOT	203.6	–3	403.3	–3	30.3	53	61.2	50	14.9	9.4	3.4	24	0.71
ENTERTAINMENT GROUP RGC	648.1	7	1176.2	15	47.1	22	82.4	67	7.3	6.4	20.5	17	1.09
ASTIC SCHL [7]	557.4	3	991.1	2	28.7	–45	28.2	–56	5.1	9.6	7.8	19	1.46
PS (E.W.) SSP †	474.8	25	920.0	27	64.7	140	117.4	76	13.6	7.1	15.3	28	2.96
NE TRB	1449.6	5	2739.7	5	229.5	101	370.7	108	15.8	8.3	12.9	20	2.36
M VIA.B	6418.3	10	12469.1	8	659.6	21	1121.2	23	10.3	9.3	3.8	33	1.36
(JOHN) & SONS JW.A [8]	203.3	7	424.5	7	8.3	NM	32.5	64	4.1	NM	25.4	19	1.39
ETAILING													
STRY GROUP COMPOSITE	**139806.2**	**4**	**304226.8**	**3**	**3500.3**	**21**	**9894.1**	**37**	**2.5**	**2.1**	**12.5**	**25**	**1.16**
STRIBUTORS													
TRY COMPOSITE	4615.2	0	9006.7	2	128.0	–7	224.6	–8	2.8	3.0	13.7	15	1.67
CED MARKETING SERVICES MKT [9]	256.6	34	462.4	25	1.9	–21	–2.5	NM	0.7	1.2	7.3	23	0.55
SONS ANDE	311.9	4	549.8	7	7.8	–10	8.2	–21	2.5	2.9	10.0	9	1.53
NE PARTS GPC	2152.8	1	4174.7	2	90.1	–6	178.6	–2	4.2	4.5	16.4	15	2.08
LEMAN HDL [8]	290.8	–12	728.4	1	8.9	–26	9.0	–54	3.1	3.7	8.9	16	1.06
ES SUPPLY HUG [11]	782.8	–1	1480.4	3	11.8	–5	19.2	8	1.5	1.6	8.9	15	2.44
O INTERNATIONAL WCC	820.2	–3	1611.0	–3	7.4	32	12.2	30	0.9	0.7	13.7	11	0.55
TERNET & CATALOG RETAIL													
TRY COMPOSITE	2125.9	37	4215.7	35	72.0	NM	136.7	NM	3.4	NM	7.8	NM	0.32
ON.COM AMZN	1099.9	37	2183.5	32	–43.3	NM	–53.4	NM	NM	NM	NM	NM	–0.22
BL	154.3**	5	291.4	3	4.1	–42	4.6	–64	2.7	4.8	4.3	16	1.37
EBAY	509.3	91	985.8	83	109.7	102	213.9	110	21.5	20.4	9.2	NM	1.15
LE MALE	218.9	7	453.7	14	0.9	106	1.2	53	0.4	0.2	16.1	10	0.66
VISION MEDIA VVTV [11]	143.5	5	301.5	12	0.5	–13	–29.6	NM	0.4	0.5	–14.6	NM	–1.09
ULTILINE RETAIL													
TRY COMPOSITE	53784.4	0	121775.7	–1	342.2	NM	1886.9	180	0.6	NM	7.5	33	0.91
TS BLI [11]	948.4	5	2165.4	6	10.2	–16	76.4	645	1.1	1.4	7.2	24	0.65
ON STORES BONT [11]	141.6**	–6	384.0	–3	–2.9	NM	12.3	18	NM	NM	5.3	8	0.72

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY	
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-24
DILLARD'S DDS [11]	1891.3**	-4	4279.2	-5	24.3	-58	96.6	-39	1.3	2.9	4.5	11
DOLLAR GENERAL DG [11]	1569.1	13	3328.6	12	60.3	31	168.4	17	3.8	3.3	20.0	22
ELDER-BEERMAN STORES EBSC [11]	138.6**	-7	361.0	-4	-2.5	NM	5.8	-6	NM	NM	1.0	38
FAMILY DOLLAR STORES FDO [4]	1176.9	15	2433.1	14	69.6	14	142.3	14	5.9	6.0	17.0	26
FEDERATED DEPARTMENT STORES FD [11]	3291.0**	-5	8308.0	-3	46.0	-48	387.0	-3	1.4	2.6	10.5	13
FRED'S FRED [11]	310.7	20	636.0	19	7.9	25	18.7	29	2.5	2.4	11.5	37
GOTTSCHALKS GOT [11]	142.1	-7	377.2	-5	-4.0	NM	-8.2	NM	NM	NM	-13.0	NM
KMART HOLDING KMRT [11]	6181.0	-14	15056.0	-17	-852.0	NM	-1959.0	NM	NM	NM	NM	NM
KOHL'S KSS [11]	2117.7	13	5302.2	15	111.0	4	390.0	15	5.2	5.7	17.7	30
MAY DEPARTMENT STORES MAY [11]	2873.0**	-7	7246.0	-6	72.0	8	459.0	-8	2.5	2.3	13.9	18
NEIMAN MARCUS GROUP NMG.A [5]	722.9**	4	1661.4	4	41.1	-12	73.6	3	5.7	6.8	10.8	15
99¢ ONLY STORES NDN	207.0	23	403.5	22	14.8	10	29.4	13	7.2	8.1	14.0	33
NORDSTROM JWN [11]	1379.2**	8	3167.1	8	27.2	NM	87.2	121	2.0	NM	10.2	20
PENNEY (J.C.) JCP [11]	7493.0	-3	17042.0	-1	61.0	-29	263.0	15	0.8	1.1	5.2	16
SAKS SKS [11]	1381.9**	-3	3223.4	-3	14.4	-29	82.6	11	1.0	1.4	2.8	25
SEARS, ROEBUCK S	10196.0	1	19076.0	-1	309.0	35	501.0	-8	3.0	2.3	24.7	8
SHOPKO STORES SKO [11]	711.0	-3	1672.4	-4	-1.1	NM	31.6	-11	NM	0.1	7.2	10
TARGET TGT [11]	10322.0**	8	24383.0	7	349.0	1	1037.0	3	3.4	3.6	17.0	21
VALUE CITY DEPARTMENT STORES VCD [11]	590.0	0	1270.3	8	-13.2	NM	-7.8	NM	NM	NM	-4.8	NM
(D) SPECIALTY RETAIL												
INDUSTRY COMPOSITE	79280.8	5	169228.7	5	2958.0	5	7645.9	22	3.7	3.8	15.3	20
ABERCROMBIE & FITCH ANF [11]	346.7	11	881.2	13	25.6	10	118.4	16	7.4	7.4	25.1	15
AMERICAN EAGLE OUTFITTERS AEOS [11]	291.9	5	783.4	6	6.4	-50	45.3	-20	2.2	4.6	14.1	18
ANNTAYLOR STORES ANN [11]	352.0	2	704.2	-2	17.9	-14	34.1	65	5.1	6.1	10.7	17
AUTONATION AN	5068.6	1	9527.9	-2	106.3	2	318.2	63	2.1	2.1	13.0	10
AUTOZONE AZO [4]	1288.4	5	2409.1	4	126.0	23	205.3	24	9.8	8.4	81.1	16
BARNES & NOBLE BKS [11]	1185.6	5	3031.7	8	-2.0	NM	109.0	61	NM	NM	11.2	16
BED BATH & BEYOND BBBY [10]	893.9	15	1943.2	17	57.5	24	162.8	26	6.4	6.0	20.4	37
BEST BUY BBY [10]	4668.0	11	11657.0	11	69.0	-13	447.0	13	1.5	1.9	22.5	22
BLOCKBUSTER BBI	1392.2	10	2910.0	12	61.2	47	146.1	36	4.4	3.3	5.4	13
BORDERS GROUP BGP [11]	758.2	0	1986.0	1	-4.8	NM	101.4	-10	NM	0.5	10.2	14
CARMAX KMX [10]	1172.8	17	2119.5	14	35.3	21	54.4	14	3.0	2.9	17.0	36
CATO CTR [11]	201.2**	0	396.1	2	17.5	-4	27.3	-7	8.7	9.1	16.0	13
CHARMING SHOPPES CHRS [11]	564.3	-11	1165.4	-9	9.7	-44	13.6	NM	1.7	2.7	6.9	15
CHICO'S FAS CHS [11]	169.0	30	307.3	33	23.4	18	38.4	30	13.8	15.2	28.2	30
CHILDREN'S PLACE RETAIL STORES PLCE [11]	181.0	5	377.7	2	5.5	-64	7.8	-77	3.1	8.8	-0.3	NM
CIRCUIT CITY STORES CC [10]	1933.3	-9	5125.7	-6	-43.9	NM	31.4	-77	NM	NM	0.0	NM
CLAIRE'S STORES CLE [11]	239.8	14	562.2	15	15.6	88	58.1	53	6.5	3.9	16.5	16
COLE NATIONAL CNJ [11]	288.2	1	583.0	0	-6.4	NM	-4.8	NM	NM	0.3	-5.9	NM
COST PLUS CPWM [11]	159.2	19	428.9	18	2.6	53	27.8	30	1.6	1.2	13.0	29
CSK AUTO CAO [11]	377.4	1	727.2	2	7.5	123	11.2	125	2.0	0.9	9.6	22
DICK'S SPORTING GOODS DKS [11]	304.7	10	699.9	13	6.7	41	25.7	46	2.2	1.7	25.7	21
DRESS BARN DBRN [5]	165.7	-6	333.1	-4	2.6	-73	7.3	-56	1.6	5.4	12.6	16
ELECTRONICS BOUTIQUE HOLDINGS ELBO [11]	303.5	28	837.0	13	3.2	116	34.8	51	1.0	0.6	14.0	16
FINISH LINE FINL [10]	207.8	22	442.2	19	6.5	78	22.0	73	3.1	2.2	10.4	18
FINLAY ENTERPRISES FNLY [11]	186.2	-1	574.1	0	-1.5	NM	26.9	10	NM	NM	15.6	6
FOOT LOCKER FL [11]	1128.0	8	2342.0	4	39.0	8	87.0	9	3.5	3.5	14.1	13
GALYAN'S TRADING COMPANY GLYN [11]	129.6	14	341.7	19	-2.6	NM	14.2	15	NM	NM	8.1	12
GAMESTOP GME [11]	321.7	19	842.1	7	6.6	85	38.2	61	2.1	1.8	9.7	15
GAP GPS [11]	3352.8	16	8003.4	15	202.5	452	451.2	NM	6.0	1.3	16.6	27
GART SPORTS GRTS [11]	228.4	-7	545.2	-3	4.2	62	17.0	66	1.8	1.1	12.2	10
GENESCO GCO [11]	192.7	1	442.5	7	3.3	-59	17.5	-27	1.7	4.3	17.5	13
GOOD GUYS GGUY [10]	143.4	-16	372.8	-13	-8.4	NM	2.8	NM	NM	NM	-5.2	NM
GOODY'S FAMILY CLOTHING GDYS [11]	283.0	0	640.5	-1	1.9	-67	5.8	NM	0.7	2.0	1.8	66
GYMBOREE GYMB [11]	139.5**	4	297.9	3	7.3	19	17.9	8	5.2	4.6	12.9	19
HOLLYWOOD ENTERTAINMENT HLYW	389.4	13	807.0	14	19.2	-54	38.8	-43	4.9	12.0	70.1	5
HOME DEPOT HD [11]	15104.0	6	28317.0	8	907.0	6	1593.0	2	6.0	6.0	18.0	20
JO-ANN STORES JAS.A [11]	374.8	1	900.6	3	4.1	-53	29.4	7	1.1	2.3	13.5	13
LIMITED BRANDS LTD [11]	1842.3	2	4808.3	10	97.5	121	454.2	30	5.3	2.5	11.2	16
LINENS 'N THINGS LIN	523.7	13	1004.1	9	5.7	2	7.8	-27	1.1	1.2	9.5	18
LITHIA MOTORS LAD	667.5	14	1251.0	13	8.5	7	12.7	-11	1.3	1.4	9.2	11
LOWE'S LOW [11]	7211.0	11	13329.0	14	421.0	22	740.0	31	5.8	5.3	17.7	24
MEN'S WEARHOUSE MW [11]	313.1	3	703.2	5	11.0	5	30.5	15	3.5	3.4	7.9	23
MICHAELS STORES MIK [11]	656.4	9	1628.3	8	20.8	10	96.2	17	3.2	3.1	14.8	18
MOTHERS WORK MWRK [3]	132.4	5	243.7	7	8.4	11	8.7	4	6.3	6.2	20.3	14
OFFICE DEPOT ODP	2815.7	7	5871.6	4	59.6	5	163.6	3	2.1	2.2	12.5	16
OFFICEMAX OMX [11]	1226.5	4	2562.0	5	6.8	-85	56.8	NM	0.6	5.4	2.5	56
PACIFIC SUNWEAR OF CALIFORNIA PSUN [11]	198.3	23	463.9	26	8.0	144	31.2	79	4.0	2.0	17.2	27
PAYLESS SHOESOURCE PSS [11]	697.7	-5	1348.3	-2	14.1	-41	19.2	NM	2.0	3.2	15.6	8

PORATE SCOREBOARD

PANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY	PRICE–EARNINGS	12 MONTHS' EARNINGS
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	RATIO 7-24	PER SHARE
NNECTION PCCC	321.6	10	605.1	15	1.4	406	3.0	NM	0.4	0.1	5.2	24	0.33
OYS–MANNY, MOE & JACK PBY [11]	529.2	–5	1012.0	–5	–6.7	NM	–8.6	NM	NM	2.4	3.7	34	0.41
ANIMAL SUPPLIES PETC [11]	384.7	10	790.1	11	11.1	NM	30.5	NM	2.9	NM	NM	24	1.00
MART PETM [11]	696.8	8	1437.3	8	24.6	11	49.2	–5	3.5	3.4	12.8	31	0.63
IMPORTS PIR [10]	402.7**	5	923.7	7	19.1	–14	73.1	3	4.7	5.8	19.7	16	1.34
SHACK RSH	1025.0	8	2095.3	8	57.5	11	114.1	4	5.6	5.2	36.3	17	1.55
QUIPMENT RDOE [11]	136.4	–8	238.8	–8	1.2	18	0.3	NM	0.9	0.7	3.5	NA	0.25
STORES ROST [11]	879.3	7	1843.9	11	49.3	8	108.1	11	5.6	5.8	30.9	17	2.56
ENTERPRISES RUSHB	193.3	12	352.9	5	2.3	9	3.2	–2	1.2	1.2	10.7	9	0.60
MM-WILLIAMS SHW	1471.7	1	2620.1	1	110.1	2	140.9	–1	7.5	7.4	24.2	14	2.06
CARNIVAL SCVL [11]	136.9	5	264.8	5	5.1	–10	6.7	–1	3.7	4.4	11.2	12	1.17
TS AUTHORITY TSA [11]	340.2	–4	730.1	–3	0.5	–71	53.4	206	0.1	0.5	26.8	6	1.71
STORES STGS [11]	198.0	–4	454.9	–4	13.4	–25	29.5	–12	6.8	8.6	11.7	10	2.47
ES SPLS [11]	3146.8	15	6481.9	14	24.8	–74	189.4	1	0.8	3.4	13.9	25	0.80
MART SMRT [11]	330.6	–7	739.0	–3	1.5	–87	11.9	–42	0.5	3.2	4.8	21	0.27
TS TLB [11]	395.0**	1	826.8	0	29.4	–16	57.7	–14	7.4	8.9	20.3	17	1.95
BCC	328.8	15	585.4	9	7.9	15	13.3	15	2.4	2.4	12.1	15	1.32
Y TIF [11]	395.8**	14	1014.9	11	35.9	10	125.2	0	9.1	9.4	15.6	27	1.30
X [11]	2788.7	5	6294.2	7	113.5	–23	267.8	–11	4.1	5.5	39.8	19	1.03
OO [11]	140.1	–12	323.1	–8	4.2	–29	29.3	–5	3.0	3.7	17.6	15	1.31
'R' US TOY [11]	2170.0	4	7039.0	3	–7.0	NM	271.0	76	NM	NM	5.6	11	1.06
OR SUPPLY TSCO	449.4	15	723.2	23	27.4	50	29.4	107	6.1	4.6	20.8	20	2.74
WORLD ENTERTAINMENT TWMC [11]	273.4	–2	757.1	–4	–5.1	NM	–9.9	NM	NM	NM	–8.2	NM	–0.79
ATE ELECTRONICS ULTE [11]	155.7	10	398.1	12	–1.4	NM	4.1	–49	NM	0.9	1.5	46	0.24
MARINE WMAR	233.0	23	344.1	20	19.8	25	13.7	2	8.5	8.3	8.0	22	0.96
MS-SONOMA WSM [11]	536.8	12	1395.8	11	13.4	–13	93.2	10	2.5	3.2	18.1	28	1.03
LC [5]	449.4	0	1357.7	1	9.4	22	–36.9	NM	2.1	1.7	–4.6	NM	–1.24
UMER STAPLES													
COMPOSITE	215057.2	5	433680.3	5	12406.8	4	23998.0	5	5.8	5.8	24.1	19	1.99
OOD & STAPLES RETAILING													
STRY GROUP COMPOSITE	128438.9	7	266460.7	7	3041.1	1	7018.3	7	2.4	2.5	17.4	26	1.48
TSON'S ABS [11]	8940.0	0	18047.0	–1	172.0	–26	371.0	–29	1.9	2.6	15.5	9	2.08
/HOLESALE CLUB BJ [11]	1475.2	15	3190.3	14	12.7	–46	61.9	–23	0.9	1.8	18.0	10	1.91
'S GENERAL STORES CASY [8]	545.2*	19	1057.7	17	6.9	58	13.9	109	1.3	1.0	9.8	18	0.80
O WHOLESALE COST [4]	9543.1**	11	19657.2	9	153.8	18	335.8	4	1.6	1.5	11.6	23	1.55
FOOD CENTERS EGLE [11]	136.2	–11	282.4	–10	–8.5	NM	–14.4	NM	NM	NM	NM	NM	–7.37
RAMA FSM [2]	254.6	8	511.7	5	0.1	–30	0.5	–67	0.1	0.1	6.1	12	2.19
ATLANTIC & PACIFIC TEA GAP [10]	3203.8	4	5724.0	2	–20.3	NM	–54.2	NM	NM	0.0	–45.9	NM	–5.94
R KR [11]	16266.0	4	28736.0	3	352.0	10	733.0	9	2.2	2.0	31.0	10	1.63
DRUG STORES LDG [11]	1103.1	1	2273.5	–1	5.8	–47	12.3	–63	0.5	1.0	3.7	26	0.70
INCH NAFC	888.6**	–2	1745.3	–3	7.3	–23	10.5	–35	0.8	1.0	10.8	8	2.07
Y PTRY [3]	711.5*	4	1384.9	11	6.1	50	3.7	NM	0.9	0.6	8.3	16	0.55
MARK STORES PTMK [11]	1004.7	3	2006.8	1	0.9	–67	8.8	NM	0.1	0.3	3.4	18	0.40
SMART PSMT [4]	169.5	5	358.5	7	–7.4	NM	–5.8	NM	NM	0.8	1.2	56	0.21
ID RAD [10]	4046.2	3	8186.1	3	–38.8	NM	–43.8	NM	NM	0.1	NM	NM	–0.38
AY SWY	7744.3	3	15287.2	3	199.6	–35	395.8	–37	2.6	4.1	8.1	28	0.72
T & FINAL SMF	431.6	5	823.4	5	–22.2	NM	–21.1	NM	NM	0.9	–8.8	NM	–0.57
VALU SVU [10]	5836.3	3	10449.2	3	73.7	–5	137.6	25	1.3	1.4	12.3	12	1.89
D NATURAL FOODS UNFI [5]	363.6	21	702.1	20	5.8	3	11.3	8	1.6	1.8	10.8	30	0.98
E SUPER MARKET VLGEA [5]	221.5	2	455.4	2	1.9	–19	5.9	–2	0.9	1.1	11.6	7	3.89
REEN WAG [4]	8328.0	13	16774.1	13	296.1	14	667.0	14	3.6	3.5	16.4	26	1.11
MART STORES WMT [11]	56718.0	10	127791.0	10	1830.0	15	4359.0	15	3.2	3.1	20.4	30	1.86
MARKETS WMK	508.0	3	1017.1	2	13.8	2	29.6	4	2.7	2.8	10.8	14	2.22
OOD BEVERAGE & TOBACCO													
STRY GROUP COMPOSITE	77267.3	2	148931.2	2	8322.7	5	15017.0	5	10.8	10.4	25.6	16	2.26
EVERAGES													
TRY COMPOSITE	26829.9	7	48768.6	7	3637.7	11	5931.8	11	13.6	13.0	30.8	23	1.85
SER-BUSCH BUD	3770.2	4	7050.8	4	632.6	9	1117.4	7	16.8	16.2	70.3	22	2.35
N-FORMAN BF.B [6]	490.9	6	1041.0	7	57.9	13	127.9	18	11.8	11.0	29.2	22	3.63
COLA KO	5691.0	6	10189.0	8	1362.0	11	2197.0	12	23.9	22.8	31.2	26	1.71
COLA BOTTLING CONSOLIDATED COKE	318.2	–3	593.4	–1	11.9	10	13.3	–6	3.7	3.3	49.2	21	2.44
COLA ENTERPRISES CCE	4617.0	9	8284.0	8	260.0	21	288.0	27	5.6	5.1	16.1	15	1.20
TELLATION BRANDS STZ [10]	771.6	19	1424.7	12	39.2	5	91.2	38	5.1	5.7	14.2	13	2.19
S (ADOLPH) RKY	1100.4	5	1928.5	8	76.3	13	77.1	–19	6.9	6.5	14.4	13	3.94
NAL BEVERAGE FIZ [8]	129.7	3	230.2	3	4.6	4	5.7	7	3.6	3.5	12.7	16	0.92
BOTTLING GROUP PBG	2532.0	15	4406.0	11	131.0	–6	170.0	–12	5.2	6.3	21.0	16	1.40
AMERICAS PAS	870.9	–1	1553.0	–3	53.2	–3	58.1	–26	6.1	6.2	7.9	16	0.78

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY	
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	PRICE–EARNINGS RATIO 7-24
PEPSICO PEP	6538.0	7	12068.0	6	1009.0	15	1786.0	14	15.4	14.3	33.4	23
(B) FOOD PRODUCTS												
INDUSTRY COMPOSITE	34511.6	2	69332.8	4	2119.0	12	4222.4	14	6.1	5.6	15.6	17
ARCHER DANIELS MIDLAND ADM [6]	8048.2	19	15956.8	34	95.0	–15	211.8	–8	1.2	1.7	5.8	18
CAMPBELL SOUP CPB [5]	1600.0	17	3518.0	11	129.0	34	360.0	20	8.1	7.0	172.4	16
CONAGRA FOODS CAG [7]	3909.5	–33	8358.4	–31	225.1	25	386.1	10	5.8	3.1	18.2	15
CORN PRODUCTS INTERNATIONAL CPO	539.3	11	1018.7	11	18.2	–2	31.8	7	3.4	3.8	7.1	17
DELTA & PINE LAND DLP [4]	168.9	25	276.5	12	28.5	14	44.6	8	16.9	18.5	12.5	31
GENERAL MILLS GIS [7]	2546.0	10	5191.0	10	225.0	295	465.0	235	8.8	2.5	22.0	19
HEINZ (H.J.) HNZ [8]	2193.3	6	4298.4	7	102.6	–43	232.5	–32	4.7	8.7	32.3	21
HERSHEY FOODS HSY	849.1	3	1802.3	–1	71.5	13	169.0	13	8.4	7.7	35.1	24
HORMEL FOODS HRL [2]	1002.6	5	2021.1	4	33.8	8	80.7	–3	3.4	3.4	15.9	17
INTERNATIONAL MULTIFOODS IMC [10]	213.9	2	431.5	1	–0.3	NM	7.0	–8	NM	1.6	9.6	20
INTERSTATE BAKERIES IBC [7]	818.0	–2	1863.6	–1	–4.6	NM	–11.3	NM	NM	2.6	8.4	17
KRAFT FOODS KFT	7841.0	4	15200.0	4	949.0	5	1797.0	13	12.1	12.0	13.1	14
McCORMICK MKC [1]	596.1	8	1151.3	7	40.0	19	75.1	11	6.7	6.1	26.0	20
PILGRIM'S PRIDE CHX [3]	651.9	2	1282.5	4	17.4	434	28.2	524	2.7	0.5	6.6	17
SANDERSON FARMS SAFM [2]	201.2	15	385.4	13	12.8	65	18.2	40	6.4	4.4	20.2	11
SENSIENT TECHNOLOGIES SXT	261.9	9	497.0	10	21.7	2	42.1	10	8.3	8.3	15.7	12
SMITHFIELD FOODS SFD [8]	1948.9	–1	3945.7	–3	5.1	–80	10.4	–87	0.3	1.3	2.0	94
SMUCKER (J.M.) SJM [8]	329.0	87	669.8	94	23.2	249	51.2	251	7.1	3.8	8.6	20
WRIGLEY (WM.) JR. WWY	792.6	12	1465.0	12	125.9	15	222.9	14	15.9	15.5	27.5	23
(C) TOBACCO												
INDUSTRY COMPOSITE	15925.9	–6	30829.9	–7	2566.0	–7	4862.8	–7	16.1	16.2	47.2	8
ALTRIA GROUP MO	15487.0	–6	29971.0	–8	2437.0	–7	4623.0	–7	15.7	15.8	45.3	8
UST UST	438.9	2	858.9	5	129.0	–6	239.8	0	29.4	31.7	NM	NM
8 HOUSEHOLD & PERSONAL PRODUCTS												
INDUSTRY GROUP COMPOSITE	**9351.0**	**6**	**18288.4**	**6**	**1043.0**	**3**	**1962.7**	**1**	**11.2**	**11.5**	**49.0**	**20**
(A) HOUSEHOLD PRODUCTS												
INDUSTRY COMPOSITE	6335.7	5	12456.2	5	810.5	3	1561.9	1	12.8	13.0	47.5	19
COLGATE-PALMOLIVE CL	2458.6	7	4807.0	7	359.8	10	683.8	11	14.6	14.2	371.6	24
DIAL DL	332.5	4	644.9	5	33.4	5	63.1	15	10.0	9.9	55.2	15
KIMBERLY-CLARK KMB	3544.6	4	7004.3	4	417.3	–2	815.0	–7	11.8	12.5	27.6	16
(B) PERSONAL PRODUCTS												
INDUSTRY COMPOSITE	3015.3	8	5832.2	7	232.5	2	400.8	2	7.7	8.1	55.2	25
ALBERTO-CULVER ACV [3]	736.1	8	1443.0	8	42.6	17	80.4	16	5.8	5.3	15.4	21
AVON PRODUCTS AVP	1656.0	8	3137.4	8	171.5	11	270.4	8	10.4	10.1	NM	27
ELIZABETH ARDEN RDEN [11]	134.8	–4	304.5	7	–15.7	NM	–15.2	NM	NM	NM	7.5	NM
NBTY NBTY [3]	308.5	22	586.3	16	29.5	–1	49.1	–11	9.6	11.8	19.2	18
PLAYTEX PRODUCTS PYX	180.0	–11	361.0	–9	4.7	–72	16.1	–65	2.6	8.3	133.3	13
ENERGY												
SECTOR COMPOSITE	**30799.9**	**21**	**61420.0**	**31**	**1921.3**	**51**	**3861.9**	**103**	**6.2**	**5.0**	**6.5**	**36**
9 ENERGY												
INDUSTRY GROUP COMPOSITE	**30799.9**	**21**	**61420.0**	**31**	**1921.3**	**51**	**3861.9**	**103**	**6.2**	**5.0**	**6.5**	**36**
(A) ENERGY EQUIPMENT & SERVICES												
INDUSTRY COMPOSITE	8354.0	10	16094.1	5	395.6	–8	710.7	–24	4.7	5.7	–7.7	NM
BAKER HUGHES BHI	1341.4	8	2567.9	5	81.6	19	129.0	–7	6.1	5.5	6.1	50
BJ SERVICES BJS [3]	546.6	24	1081.2	23	49.5	79	94.4	42	9.1	6.3	10.6	35
DIAMOND OFFSHORE DRILLING DO	163.2	–13	309.3	–21	–16.7	NM	–38.3	NM	NM	6.4	–0.6	NM
ENSCO INTERNATIONAL ESV	196.9	35	392.0	42	26.9	20	53.1	42	13.7	15.4	3.6	50
FMC TECHNOLOGIES FTI	609.9	12	1109.6	15	22.9	29	32.1	41	3.8	3.3	21.9	19
LONE STAR TECHNOLOGIES LSS	141.3	–6	269.4	–1	–9.2	NM	–17.1	NM	NM	NM	–26.2	NM
MAVERICK TUBE MVK	194.9	83	414.4	97	1.1	8	1.3	–54	0.5	0.9	0.4	NM
NOBLE NE	247.9	–2	492.9	0	43.7	–24	83.2	–24	17.6	22.6	8.0	24
PATTERSON-UTI ENERGY PTEN	195.6	56	360.9	42	12.1	NM	18.3	NM	6.2	NM	2.7	NM
ROWAN RDC	158.1	6	289.5	1	–6.6	NM	–23.8	NM	NM	NM	–1.5	NM
SCHLUMBERGER SLB	3515.7	7	6801.9	5	142.4	–25	290.3	–17	4.0	5.8	–43.4	NM
SMITH INTERNATIONAL SII	877.7	10	1686.5	4	29.9	11	51.6	–7	3.4	3.4	7.8	40
TIDEWATER TDW [9]	164.8	5	318.7	–3	18.0	–22	36.6	–29	10.9	14.4	6.1	18
(B) OIL & GAS												
INDUSTRY COMPOSITE	22445.9	26	45326.0	42	1525.7	81	3151.2	228	6.8	4.7	16.8	11
APACHE APA	1044.3	60	2019.5	71	244.4	67	556.7	145	23.4	22.4	15.4	11
ASHLAND ASH [3]	2021.0	1	3728.0	3	71.0	16	37.0	–7	3.5	3.0	4.0	23
BURLINGTON RESOURCES BR	1059.0	35	2187.0	47	278.0	54	505.0	178	26.3	21.7	19.7	12
HOLLY HOC [5]	312.2	48	582.5	54	26.7	331	25.1	339	8.6	2.9	14.4	12
MARATHON OIL MRO	8613.0	23	17699.0	43	248.0	48	551.0	143	2.9	2.4	15.8	10

PORATE SCOREBOARD

PANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY		
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	PRICE–EARNINGS RATIO 7-24	12 MONTHS' EARNINGS PER SHARE
ENERGY NBL	255.4	37	534.5	54	31.1	55	70.9	NM	12.2	8.9	8.5	24	1.51
ENTAL PETROLEUM OXY T	2266.0	21	4637.0	37	374.0	55	767.0	111	16.5	12.9	23.5	[illegible]	4.10
PRODUCING PPP	295.6	60	606.4	85	79.7	179	172.4	358	27.0	15.5	20.7	11	3.78
OR POO	2619.9	55	4996.2	72	34.5	NM	76.3	NM	1.3	NM	7.9	18	1.23
O SUN	3679.0	20	7802.0	40	81.0	500	167.0	NM	2.2	0.3	14.2	13	2.82
NERGY XTO	280.4	48	533.9	44	57.3	66	121.8	53	20.4	18.3	18.4	14	1.32
NCIALS													
R COMPOSITE	223779.0	7	438464.6	6	33850.7	31	66280.9	33	15.1	12.3	14.6	16	2.54
BANKS													
STRY GROUP COMPOSITE	**91204.2**	**5**	**178615.4**	**4**	**16342.5**	**13**	**32744.6**	**13**	**17.9**	**16.6**	**17.3**	**13**	**3.18**
OMMERCIAL BANKS													
TRY COMPOSITE	63417.1	2	124611.2	1	12584.4	18	24563.0	12	19.8	17.2	16.3	14	2.97
UTH BANCORPORATION ASO	733.2	–3	1463.7	–3	154.8	2	310.2	4	21.1	20.2	19.8	13	1.75
IATED BANC-CORP ASBC	253.9	1	504.5	2	56.7	5	114.7	10	22.3	20.8	16.8	13	2.94
RP/SOUTH BXS	176.1	–3	368.8	1	29.2	–5	68.4	13	16.6	17.0	14.0	14	1.53
OF AMERICA BAC	12250.0	7	23660.0	4	2738.0	23	5162.0	17	22.4	19.4	19.6	13	6.53
ONE ONE	5269.0	–7	10451.0	–6	856.0	2	1674.0	5	16.2	14.9	15.0	14	2.88
NORTH GROUP BNK	418.3	12	805.9	9	87.5	15	168.9	17	20.9	20.5	13.1	13	2.07
BT	1506.6	0	3006.4	2	316.2	–4	644.0	1	21.0	21.8	17.0	12	2.79
NANCIAL BOKF	229.9	1	454.0	7	41.5	20	85.7	36	18.1	15.2	14.1	14	2.65
ER ONE FINANCIAL CF	718.1	0	1425.7	2	166.0	14	313.5	9	23.1	20.2	17.9	13	2.60
ATIONAL CYN	189.4	–3	374.0	–1	46.1	1	89.7	0	24.3	23.6	16.3	14	3.61
AL BANCGROUP CNB	230.2	5	454.4	5	37.7	5	73.4	4	16.4	16.5	13.3	13	1.17
ICA CMA	853.0	–8	1719.0	–7	170.0	8	346.0	–7	19.9	16.9	11.3	14	3.29
ERGE BANCORP CBH	302.1	21	585.0	23	45.3	30	88.2	33	15.0	13.9	16.5	17	2.33
ENCE BANCSHARES CBSN	233.3	0	463.5	0	50.5	2	97.7	3	21.6	21.3	13.6	14	2.95
SS BANCSHARES CBSS	447.5	–2	896.9	–1	87.0	12	169.1	10	19.5	17.0	16.7	13	2.55
FROST BANKERS CFR	148.6	–1	294.3	–1	34.2	3	65.1	6	23.0	22.0	16.8	15	2.43
TURBO BANCORP CITB	1640.8	5	3229.1	5	437.7	8	856.7	5	26.7	26.0	19.6	19	2.89
BANCORP. FBP	145.8	–1	304.9	3	29.3	8	65.7	25	20.1	18.3	19.0	13	2.31
TENNESSEE NATIONAL FTN	814.4	29	1587.5	36	118.4	31	237.4	34	14.5	15.5	24.3	13	3.34
MERIT FMER	197.8	–4	399.2	–5	36.9	–12	75.2	–12	18.7	20.3	14.8	13	1.71
BOSTON FINANCIAL FBF	3488.0	–5	6957.0	–10	571.0	NM	1148.0	82	16.4	NM	11.8	16	1.92
NIA HIB	308.1	–5	611.4	–6	61.4	–2	117.6	–3	19.9	19.3	14.3	13	1.56
NGTON BANCSHARES HBAN	604.7	–1	1204.7	–16	97.4	33	188.0	11	16.1	12.0	15.5	14	1.49
RP KEY	1456.0	–6	2874.0	–7	225.0	–9	442.0	–9	15.5	15.9	13.3	12	2.17
TANK MTB	809.3	39	1377.7	18	134.0	17	250.6	10	16.6	19.7	9.1	18	4.86
ANTILE BANKSHARES MRBK	188.4	0	366.4	0	50.0	7	99.0	6	26.6	25.6	14.3	14	2.83
NAL CITY NCC	2583.0	17	4968.0	11	617.0	57	1113.5	33	23.9	17.8	20.6	11	3.03
NAL COMMERCE FINANCIAL NCF	389.0	0	761.7	2	71.5	–12	135.6	–13	18.4	21.3	11.2	16	1.47
FORK BANCORPORATION NFB	318.8	–1	649.6	2	96.1	–8	199.7	–2	30.1	32.4	26.3	13	2.62
ATIONAL BANCORP ONB	166.5	–3	337.9	–3	26.3	–6	53.0	1	15.8	16.3	15.7	13	1.81
INANCIAL SERVICES GROUP PNC	1468.0	–12	2955.0	–11	184.0	–43	446.0	–30	12.5	19.1	14.9	14	3.54
AR BPOP	683.8	7	1319.3	4	134.6	40	233.7	26	19.7	15.0	15.9	13	2.99
NS FINANCIAL RF	940.1	1	1857.6	0	164.8	5	323.4	5	17.5	16.5	14.6	13	2.84
NANCIAL GROUP SKYF	214.8	13	413.2	10	37.5	29	73.6	21	17.5	15.4	15.4	14	1.62
TRUST SOTR	801.8	–4	1593.6	–4	174.8	9	346.1	9	21.8	19.4	15.1	15	1.95
UST BANKS STI	1770.8	–6	3536.6	–6	330.4	–4	658.2	1	18.7	18.1	14.6	13	4.74
VUS FINANCIAL SNV	612.0	10	1197.1	8	96.4	12	186.3	10	15.7	15.4	17.9	19	1.28
NANCIAL TCB	276.7	–3	560.2	–2	60.3	4	120.4	5	21.8	20.3	25.1	14	3.30
ANCORP USB	4005.6	5	7871.2	5	953.6	16	1864.8	15	23.8	21.6	18.6	13	1.85
PLANTERS UPC	642.7	–1	1225.8	–6	133.5	4	266.8	3	20.8	19.9	16.6	12	2.69
RANCAL UB	642.2	1	1274.4	1	144.8	11	280.3	15	22.5	20.3	14.6	12	3.68
OVIA WB	5860.0	–2	11654.0	–2	1032.0	21	2059.0	16	17.6	14.2	12.0	15	2.85
S FARGO WFC	7637.0	8	15024.0	7	1525.0	7	3017.0	8	20.0	20.3	18.4	15	3.48
CORP WES	337.3	12	672.9	16	31.6	46	55.2	43	9.4	7.2	14.8	13	2.44
BANCORPORATION ZION	454.3	–3	900.1	–3	92.4	9	179.8	7	20.3	18.0	13.3	15	3.61
HRIFTS & MORTGAGE FINANCE													
STRY COMPOSITE	27787.0	12	54004.1	11	3758.1	0	8181.6	14	13.5	15.2	21.6	11	4.09
RA FINANCIAL AF	300.8	–14	609.2	–14	50.9	–20	107.3	–14	16.9	18.2	14.7	10	2.77
TRYWIDE FINANCIAL CFC	4356.9	91	7327.7	94	382.9	101	709.2	98	8.8	8.4	18.6	[illegible]	8.87
EY FINANCIAL DSL	142.4	–10	309.2	–13	18.5	–9	48.7	–16	13.0	12.9	11.9	11	3.69
E MAE FNM	13455.3	0	27011.3	3	1101.9	–25	3042.4	14	8.2	11.1	36.2	13	4.94
TAR BANCORP FBC	280.9	80	482.9	47	85.6	224	126.9	144	30.5	17.0	34.7	7	2.95
N WEST FINANCIAL GDW	954.3	5	1898.7	3	272.5	20	532.5	15	28.6	25.0	19.0	13	6.59
POINT FINANCIAL GPT	456.8	3	904.3	4	129.8	6	256.7	6	28.4	27.8	26.7	[illegible]	5.88
ON CITY BANCORP HCBK	202.6	2	406.6	5	52.5	8	104.7	14	25.9	24.4	15.1	25	1.09

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY	PRICE-EARNINGS RATIO
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	
INDEPENDENCE COMMUNITY BANK ICBC	139.2	–1	276.1	–1	34.1	6	67.1	11	24.5	22.5	13.8	13
MGIC INVESTMENT MTG	459.6**	20	882.5	16	143.8	–16	284.9	–16	31.3	44.5	15.8	9
NEW CENTURY FINANCIAL NCEN †	215.5	53	396.5	57	60.8	42	106.6	44	28.2	30.5	25.2	4
NEW YORK COMMUNITY BANCORP NYB	196.0	9	389.0	14	71.8	23	139.1	33	36.6	32.2	19.9	16
PEOPLE'S BANK (BRIDGEPORT, CONN.) PBCT	193.6	–7	396.1	–9	15.5	26	31.5	34	8.0	5.9	8.5	27
RADIAN GROUP RDN †	315.4	20	598.9	14	111.7	3	216.4	2	35.4	41.4	14.1	10
ROSLYN BANCORP RSLN	151.3	–7	312.3	–1	35.6	–3	73.1	4	23.5	22.5	27.7	12
SOVEREIGN BANCORP SOV	621.4	0	1243.0	2	104.2	15	180.0	16	16.8	14.5	11.7	14
STATEN ISLAND BANCORP SIB	227.0	53	434.1	49	25.5	24	50.9	66	11.2	13.8	18.7	10
WASHINGTON MUTUAL WM	4895.0	5	9680.0	4	1020.0	3	2023.0	4	20.8	21.2	18.9	10
WEBSTER FINANCIAL WBS	223.0	5	445.6	5	40.6	0	80.5	10	18.2	19.0	14.6	11
11 DIVERSIFIED FINANCIALS												
INDUSTRY GROUP COMPOSITE	**81877.1**	**2**	**161182.6**	**1**	**11805.6**	**53**	**22641.8**	**88**	**14.4**	**9.0**	**13.1**	**19**
(A) CAPITAL MARKETS												
INDUSTRY COMPOSITE	49200.8	1	96644.9	0	5972.2	21	11275.3	17	12.1	10.1	10.5	21
AMERITRADE HOLDING AMTD [3]	193.5	88	345.8	63	49.9	764	59.5	670	25.8	6.6	3.1	NM
BANK OF NEW YORK BK	1591.0	4	3010.0	0	295.0	–18	590.0	–18	18.5	23.6	9.5	29
BEAR STEARNS BSC [1]	1850.2	–11	3688.1	–3	280.4	–18	554.7	5	15.2	16.6	14.5	10
BLACKROCK BLK	143.9	–8	286.7	–5	38.7	11	74.0	12	26.9	22.2	19.9	21
E*TRADE GROUP ET	510.6	10	968.6	1	12.7	–61	34.2	–39	2.5	7.1	5.1	41
EDWARDS (A.G.) AGE [10]	552.9	–8	1067.1	–10	27.9	–29	49.1	NM	5.0	6.5	6.4	27
FEDERATED INVESTORS FII	178.4	–2	348.6	–4	49.1	–7	97.8	–7	27.5	28.8	61.5	17
FRANKLIN RESOURCES BEN [3]	683.9**	5	1297.0	0	131.4	5	241.0	–2	19.2	18.9	9.6	27
GOLDMAN SACHS GROUP GS [1]	5985.0	–4	12079.0	1	695.0	23	1357.0	25	11.6	9.0	11.9	18
J.P. MORGAN CHASE JPM	11842.0	6	23296.0	5	1827.0	78	3227.0	61	15.4	9.2	6.5	25
JEFFERIES GROUP JEF	230.2	15	415.5	5	18.7	6	32.9	–7	8.1	8.8	9.1	27
KNIGHT TRADING GROUP NITE	159.4**	23	285.7	9	15.9	NM	7.1	NM	10.0	NM	0.0	NM
LEGG MASON LM [9]	440.2	5	841.7	0	58.4	19	107.0	13	13.3	11.7	15.0	24
LEHMAN BROTHERS HOLDINGS LEH [1]	4470.0	3	8570.0	0	437.0	48	738.0	24	9.8	6.8	12.0	15
MELLON FINANCIAL MEL	1134.0	–5	2238.0	–7	173.0	53	340.0	7	15.3	8.8	19.0	19
MERRILL LYNCH MER	7295.0	–1	14220.0	–5	1021.0	61	1706.0	33	14.0	8.6	12.5	17
MORGAN STANLEY MWD [1]	8418.0	3	16920.0	1	599.0	–25	1504.0	–9	7.1	9.8	12.6	18
NORTHERN TRUST NTRS	671.3	–4	1301.5	–7	81.4	–35	178.0	–30	12.1	18.0	12.5	26
RAYMOND JAMES FINANCIAL RJF [3]	389.8	0	740.3	–4	23.6	16	38.8	–1	6.0	5.3	8.7	23
SCHWAB (CHARLES) SCH	1018.0	–2	1918.0	–8	126.0	29	197.0	3	12.4	9.5	2.9	NM
SEI INVESTMENTS SEIC	153.6	–3	304.2	–4	34.3	–4	69.4	–1	22.3	22.5	44.6	27
STATE STREET STT	1290.0	2	2503.0	1	–23.0	NM	73.0	–79	NM	14.1	14.4	20
(B) CONSUMER FINANCE												
INDUSTRY COMPOSITE	6935.0	5	13778.6	6	1266.8	53	2486.2	29	18.3	12.5	22.0	15
CAPITAL ONE FINANCIAL COF	2380.9	–1	4792.1	5	286.8	35	595.9	49	12.0	8.8	20.8	10
MBNA KRB	2811.7	11	5543.8	10	543.3	19	975.9	18	19.3	18.1	20.3	15
METRIS MXT	167.6	–38	371.6	–45	–15.7	NM	–40.7	NM	NM	NM	–22.7	NM
SLM SLM	1076.6	22	2071.5	18	372.7	196	789.2	44	34.6	14.3	46.4	10
STUDENT LOAN STU	211.1	–22	434.5	–20	46.1	9	107.6	17	21.8	15.7	22.4	13
WFS FINANCIAL WFSI	287.0	25	565.2	31	33.6	40	58.2	43	11.7	9.8	14.4	13
(C) DIVERSIFIED FINANCIAL SERVICES												
INDUSTRY COMPOSITE	25741.3	1	50759.1	1	4566.6	207	8880.3	NM	17.7	5.8	16.0	17
CHICAGO MERCANTILE EXCHANGE CME	142.4**	32	268.4	29	35.0	67	61.1	54	24.6	19.5	22.5	21
CIT GROUP CIT	1160.8	–8	2335.5	–10	136.9	NM	263.9	NM	11.8	NM	10.7	10
CITIGROUP C	23840.0**	1	47039.0	2	4299.0	12	8402.0	15	18.0	16.2	16.9	16
INSTINET GROUP INET	285.4	6	525.3	–2	–5.2	NM	–39.5	NM	NM	NM	–68.6	NM
MOODY'S MCO	312.7	15	590.9	17	100.9	26	192.8	27	32.3	29.0	NM	24
12 INSURANCE												
INDUSTRY GROUP COMPOSITE	**47982.6**	**20**	**93401.3**	**19**	**5406.5**	**39**	**10283.3**	**26**	**11.3**	**9.8**	**11.3**	**20**
AFLAC AFL	2861.0	14	5669.0	16	248.0	17	486.0	23	8.7	8.4	13.0	12
ALFA ALFA	154.0**	7	304.3	6	19.2	24	37.9	12	12.5	10.7	12.4	14
ALLSTATE ALL	7899.0	5	15760.0	7	588.0	71	1253.0	61	7.4	4.6	10.1	14
AMBAC FINANCIAL GROUP ABK	322.9**	23	615.7	20	162.6	56	300.5	27	50.4	45.6	12.3	14
AMERICAN INTERNATIONAL GROUP AIG	17983.0**	20	35134.3	19	2276.9	26	4230.4	12	12.7	12.1	9.6	27
BERKLEY (W.R.) BER	927.0	54	1718.4	54	95.8	250	167.5	171	10.3	4.8	18.4	10
BROWN & BROWN BRO	137.9	20	282.6	25	27.9	31	58.5	41	20.3	18.6	22.4	21
CRAWFORD CRD.B	186.6	0	363.5	–1	6.1	84	9.3	–29	3.2	2.6	12.2	14
DELPHI FINANCIAL GROUP DFG	227.7**	17	446.4	13	24.7	27	47.2	21	10.8	10.0	9.2	15
EVEREST RE GROUP RE	952.6	72	1773.8	57	109.6	105	203.9	78	11.5	9.6	10.5	12
FIDELITY NATIONAL FINANCIAL FNF	2006.3	76	3443.2	56	248.3	121	391.8	84	12.4	9.8	23.4	9
FIRST AMERICAN FAF	1542.9**	41	2984.9	35	127.5	218	215.1	155	8.3	3.7	24.5	8
GALLAGHER (ARTHUR J.) AJG	299.0	12	553.3	9	36.2	5	48.1	–29	12.1	12.9	19.2	21
HILB, ROGAL & HAMILTON HRH	139.5	48	281.5	44	19.1	52	37.2	84	13.7	13.1	19.8	17

ORATE SCOREBOARD

ANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY	PRICE–EARNINGS RATIO	12 MONTHS' EARNINGS PER SHARE
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	7-24	
& MELENNAN MMC	2865.0	10	5717.0	9	365.0	9	808.0	7	12.7	12.9	27.5	19	2.59
D MLAN	178.6	13	347.9	12	–1.0	NM	9.0	–41	NM	3.7	4.2	27	0.80
UBLIC INTERNATIONAL ORI	814.6	24	1553.7	20	121.5	13	225.9	11	14.9	16.3	12.6	10	3.41
LPHIA CONSOLIDATED HOLDING PHLY	131.2	23	288.9	41	3.6	–59	16.9	–14	2.8	8.4	6.7	27	1.49
SSIVE PGR	2918.7**	29	5635.4	30	286.3	78	577.8	72	9.8	7.1	20.7	16	4.10
	126.5	37	246.7	39	15.4	55	29.8	57	12.2	10.8	9.1	16	1.98
ARK TMK	727.8	15	1439.8	9	109.6	75	210.2	31	15.1	9.9	13.6	11	3.66
TLANTIC HOLDINGS TRH	832.0	34	1589.3	29	75.2	22	138.0	21	9.0	9.9	8.7	19	3.66
ERS PROPERTY CASUALTY TAP.B	3748.7	13	7351.7	12	441.2	33	781.2	15	11.8	10.0	3.0	47	0.33
EAL ESTATE													
TRY GROUP COMPOSITE	**2715.1**	**6**	**5265.4**	**6**	**296.2**	**–13**	**611.3**	**–14**	**10.9**	**13.4**	**5.6**	**23**	**1.19**
OPERTY AMB	154.7	5	316.9	7	12.9	–46	40.9	–16	8.4	16.2	4.4	30	0.92
BAY COMMUNITIES AVB	154.7	3	307.9	3	20.6	–39	40.5	–43	13.3	22.4	3.3	39	1.13
PROPERTIES BXP	324.7	14	647.1	17	63.2	19	172.9	71	19.5	18.7	20.8	5	5.23
CITY ENTERPRISES FCE.A [11]	243.9	15	492.6	8	14.8	61	31.9	45	6.1	4.4	6.9	41	0.98
ARRIOTT HMT	873.0	–5	1675.0	–2	–14.0	NM	–48.0	NM	NM	2.5	–10.1	NM	–0.47
PROPERTY TRUST LRY	152.8	4	311.6	5	33.4	–17	74.6	–7	21.8	27.1	10.5	18	1.88
EEK TIMBER PCL	318.0	17	591.0	8	58.0	9	91.0	–17	18.2	19.6	10.0	23	1.16
IS PLD †	169.4	–3	329.3	–5	55.7	–14	102.5	–20	32.9	37.3	7.4	26	1.05
ICE	184.5	27	331.0	24	9.9	–18	24.3	–71	5.4	8.3	19.1	58	1.16
URG MORTGAGE TMA	139.4	43	262.9	49	41.6	49	80.7	55	29.9	28.9	14.5	10	2.67
H CARE													
COMPOSITE	132944.7	14	258713.1	13	6659.2	–44	21048.9	–17	5.0	10.2	20.4	28	1.50
EALTH CARE EQUIPMENT & SERVICES													
TRY GROUP COMPOSITE	**74700.5**	**14**	**145541.9**	**14**	**3283.7**	**6**	**6822.8**	**12**	**4.4**	**4.7**	**18.7**	**25**	**1.63**
ALTH CARE EQUIPMENT & SUPPLIES													
RY COMPOSITE	11868.9	16	22892.0	15	1331.9	–2	2897.5	5	11.2	13.3	19.4	32	1.38
T TECHNOLOGIES AOT [3]	278.5	4	555.1	5	35.7	5	66.6	2	12.8	12.7	16.5	17	1.25
BIOSYSTEMS GROUP ABI [6]	432.9	4	842.3	2	96.1	152	136.2	56	22.2	9.1	16.3	22	0.95
R.) BCR	354.2	12	690.1	11	49.5	13	96.4	23	14.0	13.8	18.3	21	3.29
& LOMB BOL	512.5	12	960.5	10	28.3	29	44.8	46	5.5	4.8	8.1	24	1.61
INTERNATIONAL BAX	2163.0	11	4160.0	9	49.0	–76	266.0	–42	2.3	10.5	28.5	20	1.38
, DICKINSON BDX [3]	1165.4	17	2299.4	14	130.0	9	272.1	9	11.2	12.0	19.2	19	1.96
BMET [7]	377.2	16	731.3	16	77.7	28	150.3	23	20.6	18.6	23.4	26	1.10
SCIENTIFIC BSX	854.0	21	1661.0	20	114.0	356	211.0	97	13.3	3.5	18.0	52	1.14
S LIFESCIENCES EW	217.8	26	430.3	28	21.1	–31	35.6	–31	9.7	17.7	7.1	42	0.64
T GDT	944.9	20	1820.6	23	–79.7	NM	79.0	–78	NM	27.6	11.5	42	1.14
RE IVC	300.1	10	576.8	9	15.4	–4	27.7	–1	5.1	5.9	11.8	17	2.05
NIC MDT [8]	2147.8	20	4060.3	20	487.1	62	914.8	49	22.7	16.8	20.2	39	1.30
RE MIL	196.4	11	383.8	12	22.3	8	43.6	4	11.3	12.7	23.1	26	1.70
E MEDICAL STJ	495.1	22	936.5	21	81.9	18	161.9	23	16.5	17.2	16.4	31	1.65
R SYK	891.7	22	1738.6	21	107.5	25	211.6	27	12.1	11.7	21.5	39	1.92
HARMACEUTICAL SERVICES WST	126.4	19	244.2	17	6.9	33	10.7	–7	5.5	4.9	5.7	31	0.83
HOLDINGS ZMH	411.1	19	801.2	21	89.0	35	169.2	40	21.6	19.1	47.3	30	1.55
ALTH CARE PROVIDERS & SERVICES													
RY COMPOSITE	62831.5	14	122649.9	14	1951.8	12	3925.3	16	3.1	3.1	18.2	19	1.94
EPCS ADVP [9]	3804.0	18	7419.1	16	48.4	31	94.3	31	1.3	1.1	17.3	21	1.87
OURCEBERGEN ABC [3]	12420.7	7	24583.2	9	112.5	25	229.0	26	0.9	0.8	10.7	17	3.72
EALTHCARE GROUP AHG	343.3	11	678.4	11	29.4	12	57.2	16	8.6	8.4	30.4	11	2.23
CERN	207.7	11	405.9	10	8.9	–39	14.5	–42	4.3	7.9	8.4	28	1.05
CBZ	410.8	8	814.7	8	16.1	–29	27.2	–24	3.9	6.0	17.8	16	1.31
E CVD	242.3	5	485.4	8	18.3	39	36.2	45	7.5	5.7	15.3	16	1.21
S SCRIPTS ESRX	3334.2	5	6558.2	15	59.0	21	118.7	28	1.8	1.5	20.2	22	2.89
A	5467.0	12	10740.0	10	240.0	–31	709.0	–4	4.4	7.1	13.5	21	1.55
MANAGEMENT ASSOCIATES HMA [3]	647.1	9	1293.6	10	75.9	14	154.0	13	11.7	11.2	17.5	17	1.09
ALTH RX	337.8	11	651.7	10	55.4	3	2.2	–98	16.4	17.7	221.9	36	0.52
TORY CORP. OF AMERICA HOLDINGS LH	743.7	21	1455.9	21	86.4	10	160.3	11	11.6	12.8	15.5	17	1.86
E HOLDINGS LNCR	283.1	21	548.3	18	56.8	22	109.7	20	20.1	19.8	24.8	18	1.92
SON MCK [9]	16524.2	21	31410.5	15	155.6	32	337.2	38	0.9	0.9	13.2	17	2.04
& MINOR OMI	1054.5	8	2072.5	6	13.6	13	26.5	19	1.3	1.2	18.0	18	1.38
SON DENTAL PDCO [8]	447.3	12	868.4	15	33.6	22	63.7	22	7.5	6.9	18.4	29	1.70
CEUTICAL PRODUCT DEVELOPMENT PPDI	185.0	22	354.8	26	16.8	–2	38.0	NM	9.1	11.4	15.5	18	1.37
Y HEALTHCARE PHCC	350.5	20	702.0	26	11.4	7	24.6	21	3.3	3.7	15.0	18	1.09
DIAGNOSTICS DGX	1219 9	14	2312.7	15	120.4	28	208.4	36	9.9	8.2	15.9	16	3.67
HEALTH SERVICES BIE	370.2	17	722.5	16	20.5	95	35.9	103	5.5	3.3	36.3	14	1.95
RT ENTERPRISES STEI [2]	133.4	–12	264.6	–13	9.5	–26	19.0	–26	7.1	8.5	3.0	18	0.24
HEALTH GROUP UNH	7087.0**	17	14062.0	16	439.0	35	842.0	36	6.2	5.3	33.7	21	2.52

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY	PRICE–EARNINGS
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	RATIO 7-24
UNIVERSAL HEALTH SERVICES UHS	903.0**	12	1797.8	12	51.0	15	103.7	15	5.6	5.5	19.4	16
WELLCHOICE WC	1374.5	4	2666.6	2	48.8	–19	96.5	–31	3.5	4.5	26.1	NA
WELLPOINT HEALTH NETWORKS WLP	4940.4**	15	9781.1	19	284.5	35	417.5	36	4.5	3.9	18.3	16
15 PHARMACEUTICALS & BIOTECHNOLOGY												
INDUSTRY GROUP COMPOSITE	**58244.3**	**14**	**113171.2**	**12**	**3375.5**	**–62**	**14226.1**	**–26**	**5.8**	**17.3**	**21.1**	**30**
(A) BIOTECHNOLOGY												
INDUSTRY COMPOSITE	3836.9	43	7277.1	45	929.7	172	1761.0	104	24.2	12.8	0.4	NM
AMGEN AMGN	2041.1	63	3802.3	68	607.2	47	1100.5	46	29.7	33.0	–5.5	NM
BIOGEN BGEN	325.6	21	646.3	16	57.9	33	121.4	5	17.8	16.1	12.0	29
CHIRON CHIR †	322.8	19	617.4	22	61.5	22	122.5	29	19.0	18.6	12.2	30
GENENTECH DNA	799.7	29	1549.4	30	132.3	NM	283.8	NM	16.5	NM	8.0	87
GENZYME GENERAL GENZ	347.7	30	661.7	30	70.8	43	132.7	55	20.4	18.6	8.2	47
(B) PHARMACEUTICALS												
INDUSTRY COMPOSITE	54407.4	13	105894.1	10	2445.8	–71	12465.1	–32	4.5	17.6	26.5	25
ABBOTT LABORATORIES ABT †	4723.6	9	9304.1	9	246.6	–58	1047.6	–28	5.2	13.7	21.1	26
ALLERGAN AGN	447.7	29	848.7	26	–107.9	NM	–37.7	NM	NM	NM	–1.3	NM
ALPHARMA ALO	334.4	11	638.4	11	–4.2	NM	3.7	NM	NM	3.4	–6.9	NM
BRISTOL-MYERS SQUIBB BMY	5052.0	22	9763.0	11	878.0	83	1639.0	24	17.4	11.6	25.3	22
FOREST LABORATORIES FRX [9]	605.7**	30	1226.9	35	179.8	45	360.6	54	29.7	26.5	26.8	26
JOHNSON & JOHNSON JNJ	10332.0	14	20154.0	13	1210.0	–27	3281.0	–6	11.7	18.2	26.6	24
LILLY (ELI) LLY	3088.2	11	5977.6	12	692.2	5	1099.2	–15	22.4	23.7	29.0	29
MERCK MRK	13281.2	4	26669.7	7	1867.0	7	3577.4	5	14.1	13.7	38.9	18
MYLAN LABORATORIES MYL [9]	331.4	20	685.1	23	83.9	30	157.7	22	25.3	22.5	20.1	20
PFIZER PFE	9993.0	37	18518.0	23	–3674.0	NM	–1215.0	NM	NM	25.9	14.9	53
SCHERING-PLOUGH SGP	2338.0	–17	4411.0	–18	182.0	–71	355.0	–71	7.8	22.3	13.6	24
SICOR SCRI	133.6	19	262.0	18	28.0	8	54.4	10	21.0	23.7	17.6	15
WYETH WYE	3746.6	7	7435.6	4	864.4	44	2142.3	46	23.1	17.1	53.5	13
INDUSTRIALS												
SECTOR COMPOSITE	**209426.8**	**5**	**401121.6**	**6**	**13044.7**	**5**	**19549.5**	**–6**	**6.2**	**6.2**	**13.0**	**25**
16 CAPITAL GOODS												
INDUSTRY GROUP COMPOSITE	**141261.4**	**5**	**269072.4**	**5**	**8715.6**	**–13**	**15045.8**	**–14**	**6.2**	**7.5**	**14.9**	**23**
(A) AEROSPACE & DEFENSE												
INDUSTRY COMPOSITE	47854.7	5	92090.5	4	1651.1	–43	2704.8	–47	3.5	6.4	9.6	31
AAR AIR [7]	145.1	–2	302.1	4	–7.5	NM	–6.9	NM	NM	NM	–4.2	NM
B/E AEROSPACE BEAV	151.8	0	306.5	3	–14.1	NM	–24.9	NM	NM	NM	NA	NA
BOEING BA	12785.0	–8	25045.0	–10	–192.0	NM	–670.0	NM	NM	5.6	4.2	92
ENGINEERED SUPPORT SYSTEMS EASI [2]	125.1	36	246.7	35	8.5	29	16.9	36	6.8	7.2	20.0	22
ESTERLINE TECHNOLOGIES ESL [2]	135.3	34	261.6	32	6.0	–16	11.9	–14	4.5	7.2	8.0	13
GENCORP GY [1]	315.0	4	586.0	6	10.0	67	13.0	44	3.2	2.0	8.3	12
GENERAL DYNAMICS GD	3935.0	12	7356.0	11	242.0	–11	463.0	–8	6.2	7.8	18.7	10
GOODRICH GR	1094.5	22	2188.7	22	14.7	–75	–18.1	NM	1.3	6.4	4.2	58
HEXCEL HXL	234.1	6	462.7	4	4.8	–9	1.6	NM	2.1	2.4	NM	NM
HONEYWELL INTERNATIONAL HON	5749.0	2	11148.0	3	319.0	–31	593.0	–29	5.5	8.1	–4.7	NM
KAMAN KAMNA	216.3	3	432.3	0	3.3	NM	17.3	NM	1.5	NM	9.4	9
L-3 COMMUNICATIONS HOLDINGS LLL	1226.9	28	2315.9	40	53.4	60	103.1	85	4.4	3.3	10.8	19
LOCKHEED MARTIN LMT	7709.0	23	14768.0	20	242.0	–31	492.0	–14	3.1	5.6	7.4	52
ORBITAL SCIENCES ORB	158.4	17	295.1	15	–4.6	NM	–1.2	NM	NM	4.0	3.4	84
PRECISION CASTPARTS PCP [9]	481.7	–17	995.9	–17	34.5	–18	72.6	–20	7.2	7.3	14.3	11
RAYTHEON RTN	4429.0	8	8630.0	8	186.0	–17	297.0	–20	4.2	5.4	7.5	19
ROCKWELL COLLINS COL [3]	620.0	0	1238.0	1	77.0	28	136.0	15	12.4	9.6	23.4	18
UNITED DEFENSE INDUSTRIES UDI	553.5	74	1019.9	51	36.1	32	74.5	61	6.5	8.6	1448.1	9
UNITED TECHNOLOGIES UTX	7790.0	5	14492.0	6	632.0	1	1134.0	4	8.1	8.5	23.6	15
(B) BUILDING PRODUCTS												
INDUSTRY COMPOSITE	5382.4	5	9855.5	5	228.2	–8	312.0	–3	4.2	4.9	22.5	15
AMERICAN STANDARD ASD	2265.0	9	4215.6	10	133.9	6	197.7	8	5.9	6.0	86.6	19
AMERICAN WOODMARK AMWD [8]	144.3	8	281.0	10	7.6	–17	14.3	–15	5.2	6.9	20.4	13
APOGEE ENTERPRISES APOG [10]	171.3	–7	359.0	–4	0.3	–94	5.3	–45	0.2	2.3	12.0	13
LENNOX INTERNATIONAL LII	819.2	–1	1469.0	–2	30.4	19	32.9	26	3.7	3.1	12.3	14
NCI BUILDING SYSTEMS NCS [2]	199.2	–7	407.1	–8	2.0	–58	5.9	–26	1.0	2.3	9.7	11
SIMPSON MFG. SSD	146.5	16	262.9	16	17.7	19	28.7	17	12.1	12.0	14.6	18
UNIVERSAL FOREST PRODUCTS UFPI	552.5	9	908.1	7	17.2	12	21.7	1	3.1	3.0	12.9	11
YORK INTERNATIONAL YRK	1084.4	4	1952.8	4	19.2	–60	5.6	–83	1.8	4.6	7.2	21
(C) CONSTRUCTION & ENGINEERING												
INDUSTRY COMPOSITE	4051.7	7	7931.0	13	62.6	–34	94.3	–44	1.5	2.5	6.9	23
DYCOM INDUSTRIES DY [5]	139.7	–18	276.8	–10	2.8	–64	1.7	–87	2.0	4.5	–11.7	NM
EMCOR GROUP EME	1144.4	16	2205.4	23	8.3	–44	11.5	–48	0.7	1.5	10.3	12

ORATE SCOREBOARD

AMY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY		
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	PRICE–EARNINGS RATIO 7-24	12 MONTHS EARNINGS PER SHARE
ENGINEERING GROUP JEC [3]	1131.1	–3	2333.7	1	32.9	18	64.3	17	2.9	2.4	16.0	19	2.20
ROUP SGR [4]	824.0	–9	1544.4	5	3.1	–88	–4.8	NM	0.4	3.0	6.6	8	0.99
S [2]	812.6	44	1570.6	42	15.6	–8	21.5	–29	1.9	3.0	6.4	12	1.57
ECTRICAL EQUIPMENT													
RY COMPOSITE	5639.8	2	10993.9	3	336.0	5	544.0	4	6.0	5.6	10.4	21	1.34
BRANDS AYI [4]	521.0	3	1010.4	4	15.3	5	23.0	–8	2.9	2.9	11.4	15	1.18
AME	276.9	4	544.4	5	21.8	2	41.5	1	7.9	8.0	19.4	16	2.51
ELECTRIC BEZ	138.5	–5	275.9	–1	6.0	–17	12.2	–4	4.3	5.0	9.2	29	0.69
BWC	214.1	3	410.4	–1	–0.8	NM	–3.1	NM	NM	2.3	–7.9	NM	–1.00
BRC [5]	142.0	9	271.5	8	8.6	1	11.4	–22	6.1	6.5	7.4	31	1.07
INDUSTRIES CBE	1010.9	1	1968.7	0	72.4	–2	129.0	5	7.2	7.4	10.5	18	2.37
CABLE BGC	398.0	1	750.6	–1	3.0	NM	3.1	NM	0.8	NM	–10.0	NM	–0.25
GROUP GLYT	254.1	5	492.0	5	9.8	–8	18.6	–4	3.9	4.3	12.5	13	2.96
HUB.B	449.3	9	868.7	21	24.2	–21	45.9	–9	5.4	7.4	13.7	20	1.73
EDIT RBC	154.6	0	308.0	1	6.5	–8	12.6	–2	4.2	4.5	6.2	20	0.96
ELL AUTOMATION ROK [3]	1033.0	4	2062.0	5	128.0	42	177.0	20	12.4	9.0	15.8	19	1.41
NDUSTRIES ROP [2]	165.5	10	303.8	2	14.7	–15	23.1	–28	8.9	11.5	13.9	21	1.80
A.O.) AOS	417.6	8	805.5	5	19.8	10	33.5	11	4.7	4.7	10.0	18	1.85
& BETTS TNB	322.7	–5	634.1	–7	6.8	NM	11.8	NM	2.1	0.1	2.2	56	0.26
ARD GOVERNOR WGOV [3]	141.6	–18	287.8	–17	–0.2	NM	4.3	–85	NM	8.5	3.9	34	1.22
USTRIAL CONGLOMERATES													
RY COMPOSITE	42117.1	1	80909.1	1	4575.5	–10	8447.1	–8	10.9	12.2	21.3	20	1.59
ALE	399.2	6	811.2	12	37.4	10	75.8	12	9.4	9.2	9.6	17	1.55
E CSL	554.4	0	1030.1	2	28.6	15	45.7	22	5.2	4.5	13.6	17	2.62
ELECTRIC GE	33225.0**	0	63626.0	0	3794.0	–14	7008.0	–12	11.4	13.3	21.4	19	1.42
X TYX	577.9	6	1124.2	7	31.8	–5	61.1	–5	5.5	6.1	12.3	14	3.08
N TXT	2599.0**	–8	5056.0	–4	63.0	–40	129.0	–20	2.4	3.7	9.7	18	2.40
M	4580.0	10	8898.0	11	619.0	33	1121.0	22	13.5	11.2	31.3	25	5.50
AR TG	181.6	–9	363.6	–4	1.7	–88	6.5	–73	0.9	7.1	1.8	74	0.20
CHINERY													
RY COMPOSITE	34012.9	11	63051.6	12	1756.1	33	2754.6	40	5.2	4.3	10.8	25	1.78
T ATU [4]	147.2	23	289.3	27	10.0	NM	17.1	469	6.8	NM	NM	21	2.24
	902.7	17	1659.9	19	15.6	11	28.1	134	1.7	1.8	–5.8	NM	–0.59
INTERNATIONAL AIN	223.6	10	434.0	10	16.0	14	37.0	62	7.1	6.8	14.2	13	2.09
GROUP B	229.6	10	448.3	11	9.7	12	17.1	11	4.2	4.1	9.8	16	1.44
LLAR CAT	5932.0	12	10753.0	11	399.0	100	528.0	89	6.7	3.8	17.6	21	3.01
R CLC [1]	185.8	5	357.3	7	13.0	23	22.6	22	7.0	6.0	15.1	20	1.99
R DHR	1299.4	13	2495.6	16	125.1	21	228.3	22	9.6	9.0	14.5	23	3.02
E [2]	4400.0**	10	7193.6	11	256.9	81	324.9	214	5.8	3.6	15.3	21	2.24
SON DCI [5]	302.5	12	586.9	10	25.3	18	45.3	7	8.4	8.0	21.2	23	2.06
OV	1124.2	4	2152.0	4	73.4	12	131.8	16	6.5	6.0	9.5	31	1.13
TN	2027.0	8	3952.0	10	93.0	6	165.0	36	4.6	4.7	11.6	19	4.51
SIGNAL FSS	311.0	21	603.0	20	9.9	–7	16.4	–20	3.2	4.2	10.3	21	0.91
RVE FLS	614.0	4	1178.0	13	13.2	–8	21.5	–21	2.2	2.4	6.0	21	0.88
GG	146.4	10	266.0	11	24.5	14	42.7	15	16.7	16.2	34.8	21	1.70
	207.1	9	402.6	10	16.9	9	29.6	9	8.2	8.2	10.4	21	1.72
TOOL WORKS ITW	2564.0	5	4877.8	5	284.0	7	483.5	5	11.1	10.9	13.1	21	3.10
LL-RAND IR	2525.1	11	4723.8	10	153.1	66	246.6	53	6.1	4.0	11.3	20	2.66
STRIES JLG [5]	205.8	–1	357.1	–2	2.2	159	6.4	195	1.1	0.4	6.1	23	0.35
BAL JOYG [2]	298.9	8	538.0	–7	2.4	NM	–3.1	NM	0.8	NM	0.4	NM	0.04
ELECTRIC HOLDINGS LECO	265.0	2	514.2	1	14.2	–28	26.4	–13	5.4	7.6	14.1	15	1.48
R INDUSTRIES MLI	248.2**	–5	480.2	–6	9.0	–52	13.4	–63	3.6	7.2	6.5	21	1.30
INDUSTRIES NC	637.5	5	1257.4	5	9.6	243	12.5	37	1.5	0.5	9.4	11	6.47
AR INTERNATIONAL NAV [2]	1864.0	11	3442.0	10	–12.0	NM	–110.0	NM	NM	NM	NM	NM	–8.57
N NDSN [2]	166.7	2	312.0	1	8.1	4	13.1	–3	4.9	4.8	7.8	38	0.64
H TRUCK OSK [3]	538.2	10	991.6	10	24.2	12	38.3	14	4.5	4.4	13.8	16	3.84
PCAR	2012.2	12	3929.0	19	124.1	66	234.9	94	6.2	4.1	16.5	17	4.17
L [5]	421.5	39	810.0	38	40.4	53	71.7	60	9.6	8.7	6.5	49	0.46
PNR	719.0	2	1356.5	3	43.9	2	71.7	11	6.1	6.1	11.7	15	2.76
E STEEL & ALUMINUM RS	456.3	1	907.2	5	6.4	–41	12.0	–34	1.4	2.4	3.9	28	0.75
S & MYERS RBN [4]	144.9	16	279.1	10	4.4	64	7.5	9	3.0	2.2	4.0	26	0.82
T & STEVENSON SERVICES SVC [11]	289.8	–3	584.1	–4	1.7	–66	–2.1	NM	0.6	1.6	2.0	61	0.26
EX	1007.4	54	1886.7	57	–49.7	NM	–37.9	NM	NM	1.7	–8.3	NM	–1.39
TKR	990.3	50	1828.3	43	3.9	–1	15.3	16	0.4	0.6	5.7	19	0.79
T INDUSTRIES VMI	200.7	–11	408.0	–6	6.4	–38	13.7	–22	3.2	4.6	12.2	16	1.23
NATIONAL WNC	230.2	10	452.7	22	–27.3	NM	–25.8	NM	NM	NM	–62.2	NM	–1.85
WAB	174.9	–3	344.4	–4	5.6	17	11.1	51	3.2	2.6	10.2	29	0.49

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY	PRICE-EARNINGS
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	RATIO 7-24
(G) TRADING COMPANIES & DISTRIBUTORS												
INDUSTRY COMPOSITE	2202.8	1	4240.9	1	106.1	9	189.1	2	4.8	4.5	12.1	23
FASTENAL FAST	249.1	7	485.0	8	21.9	4	41.0	6	8.8	9.0	14.2	34
GRAINGER (W.W.) GWW	1172.7	–2	2311.9	0	56.0	5	108.4	–4	4.8	4.6	13.4	19
HUTTIG BUILDING PRODUCTS HBP	224.9	2	420.9	–4	1.6	NM	–3.4	NM	0.7	NM	–0.2	NM
MSC INDUSTRIAL DIRECT MSM [4]	215.6	3	425.2	5	13.2	19	25.9	33	6.1	5.3	9.2	28
WATSCO WSO	340.5	3	597.9	2	13.4	8	17.2	11	3.9	3.8	6.8	17
17 COMMERCIAL SERVICES & SUPPLIES												
INDUSTRY GROUP COMPOSITE	22093.1	11	41868.0	14	1583.0	16	2641.2	15	7.2	6.8	16.2	23
ABM INDUSTRIES ABM [2]	589.8**	12	1170.5	11	9.9	–29	14.2	–35	1.7	2.7	10.0	20
APOLLO GROUP APOL [4]	364.2	32	659.3	32	74.3	46	119.9	52	20.4	18.4	23.8	54
AVERY DENNISON AVY	1192.2	14	2327.4	19	69.7	–3	138.1	2	5.8	6.9	20.8	20
BLOCK (H&R) HRB [6]	1918.6	2	2877.0	10	494.6	7	627.0	27	25.8	24.6	34.9	14
CAREER EDUCATION CECO	256.1	44	501.6	41	19.6	90	38.8	74	7.7	5.8	17.7	46
CDI CDI	270.0	–10	539.5	–12	6.1	323	11.6	NM	2.3	0.5	5.3	30
CENDANT CD	4580.0	21	8674.0	36	382.0	60	691.0	25	8.3	6.3	12.2	15
CHOICEPOINT CPS	199.2	9	394.2	12	20.9	–7	52.1	8	10.5	12.3	16.0	30
CINTAS CTAS [7]	676.1	12	1339.9	17	65.2	2	124.3	4	9.6	10.6	15.1	27
CONSOLIDATED GRAPHICS CGX [9]	165.8	–6	331.9	–3	3.6	–29	–25.6	NM	2.2	2.9	–6.5	NM
DELUXE DLX	309.6	–6	626.8	–5	44.9	–18	94.9	–13	14.5	16.7	NM	14
DUN & BRADSTREET DNB	335.0	10	649.7	5	35.1	222	72.2	63	10.5	3.6	NM	18
EQUIFAX EFX	317.0	18	618.6	17	49.3	3	94.4	5	15.6	17.8	60.1	16
GENERAL BINDING GBND	171.2	–2	340.6	–2	–5.1	NM	–5.0	NM	NM	1.2	–5.0	NM
HEWITT ASSOCIATES HEW [3]	507.7	16	999.7	17	26.4	18	50.0	–47	5.2	5.1	13.0	32
HON INDUSTRIES HNI	406.8	2	798.8	0	20.2	0	36.1	0	5.0	5.0	14.0	20
KELLY SERVICES KELYA	1059.5	4	2062.9	5	1.5	–62	1.8	–62	0.1	0.4	2.5	57
LABOR READY LRW	215.7	–2	388.0	0	5.2	51	2.0	NM	2.4	1.6	10.4	25
MANPOWER MAN	3013.4	16	5692.1	16	29.1	13	44.0	35	1.0	1.0	11.2	22
MILLER (HERMAN) MLHR [7]	321.9	0	632.3	–5	–1.3	NM	1.7	NM	NM	NM	12.2	66
PITNEY BOWES PBI	1133.9	5	2224.7	4	118.9	–17	232.8	–15	10.5	13.2	41.1	22
ROBERT HALF INTERNATIONAL RHI	483.0	2	956.2	2	0.1	–96	–3.3	NM	0.0	0.7	–1.8	NM
ROLLINS ROL	185.1	0	340.2	1	13.9	19	21.1	27	7.5	6.3	28.2	38
SCHOOL SPECIALTY SCHS [8]	144.1	8	254.6	7	–4.9	NM	–13.4	NM	NM	NM	12.3	14
STEELCASE SCS [10]	571.9	–11	1209.7	–7	–13.4	NM	4.2	NM	NM	NM	–2.8	NM
TETRA TECH TTEK [3]	231.8	25	424.7	17	13.8	71	25.2	88	6.0	4.4	12.8	22
UNITED STATIONERS USTR	955.5	6	1925.7	8	15.1	–4	33.9	–15	1.6	1.8	9.1	22
UNIVERSITY OF PHOENIX ONLINE UOPX [4]	145.8	60	262.8	61	31.7	61	54.0	67	21.7	21.6	39.1	69
VIAD VVI	439.8	9	854.2	1	40.9	38	62.9	8	9.3	7.3	15.1	18
VOLT INFORMATION SCIENCES VOL [2]	403.4	11	755.9	9	–0.4	NM	–4.2	NM	NM	NM	0.7	NM
WASTE CONNECTIONS WCN	138.9	8	267.3	14	16.6	16	31.1	17	12.0	11.2	12.2	17
WEST WSTC	237.6	22	453.7	12	20.9	3	41.0	–4	8.8	10.4	11.0	26
WORKFLOW MANAGEMENT WORK [8]	152.5	–4	313.4	0	–21.3	NM	–27.5	NM	NM	1.8	–43.3	NM
18 TRANSPORTATION												
INDUSTRY GROUP COMPOSITE	46072.3	3	90181.2	4	2746.1	188	1862.4	106	6.0	2.1	5.9	47
(A) AIR FREIGHT & LOGISTICS												
INDUSTRY COMPOSITE	18025.4	7	35374.0	7	1079.1	15	1914.0	14	6.0	5.6	20.0	22
CNF CNF	1236.9	4	2443.1	8	18.4	–16	36.3	–14	1.5	1.8	14.8	14
FEDEX FDX [7]	5830.0	8	11375.0	9	280.0	19	427.0	20	4.8	4.4	11.4	24
HUNT (J.B.) TRANSPORT SERVICES JBHT	599.9	8	1171.1	10	25.1	62	36.3	79	4.2	2.8	11.8	28
ROBINSON (C.H.) WORLDWIDE CHRW	935.2	11	1752.0	11	29.0	15	55.8	21	3.1	3.0	22.7	29
RYDER SYSTEM R	1197.4	–1	2391.8	1	34.7	16	55.6	20	2.9	2.4	10.3	14
UNITED PARCEL SERVICE UPS	8226.0	7	16241.0	6	692.0	13	1303.0	11	8.4	8.0	26.4	21
(B) AIRLINES												
INDUSTRY COMPOSITE	15164.2	–2	29430.7	0	813.0	NM	–1381.6	NM	5.4	NM	NM	NM
ALASKA AIR GROUP ALK	609.1	6	1127.8	5	45.2	NM	–11.1	NM	7.4	NM	–6.5	NM
AMERICA WEST HOLDINGS AWA	575.8	6	1099.0	9	79.7	NM	17.7	NM	13.8	NM	–69.0	NM
AMR AMR	4324.0	–4	8444.0	–3	–75.0	NM	–1118.0	NM	NM	NM	NM	NM
CONTINENTAL AIRLINES CAL	2216.0	1	4258.0	2	79.0	NM	–142.0	NM	3.6	NM	–45.5	NM
DELTA AIR LINES DAL	3307.0	–5	6462.0	–2	184.0	NM	–282.0	NM	5.6	NM	NM	NM
EXPRESSJET HOLDINGS XJT	320.3	19	626.9	17	27.1	31	52.8	30	8.5	7.6	142.1	10
NORTHWEST AIRLINES NWAC	2297.0	–5	4547.0	–1	227.0	NM	–169.0	NM	9.9	NM	NM	NM
SOUTHWEST AIRLINES LUV	1515.0	8	2866.0	5	246.0	141	270.0	120	16.2	6.9	8.2	35
(D) ROAD & RAIL												
INDUSTRY COMPOSITE	12882.8	3	25376.5	5	854.0	4	1330.0	–5	6.6	6.6	9.0	15
ARKANSAS BEST ABFS	377.9	8	737.5	11	15.2	134	14.5	82	4.0	1.9	12.9	14
BURLINGTON NORTHERN SANTA FE BNI	2294.0	8	4526.0	4	200.0	8	348.0	–5	8.7	8.8	9.1	14
COVENANT TRANSPORT CVTI	137.4	–1	265.5	–1	3.2	6	4.0	205	2.3	2.1	6.1	24
CSX CSX	1942.0	–6	3958.0	–2	127.0	–6	169.0	–17	6.5	6.5	6.7	16

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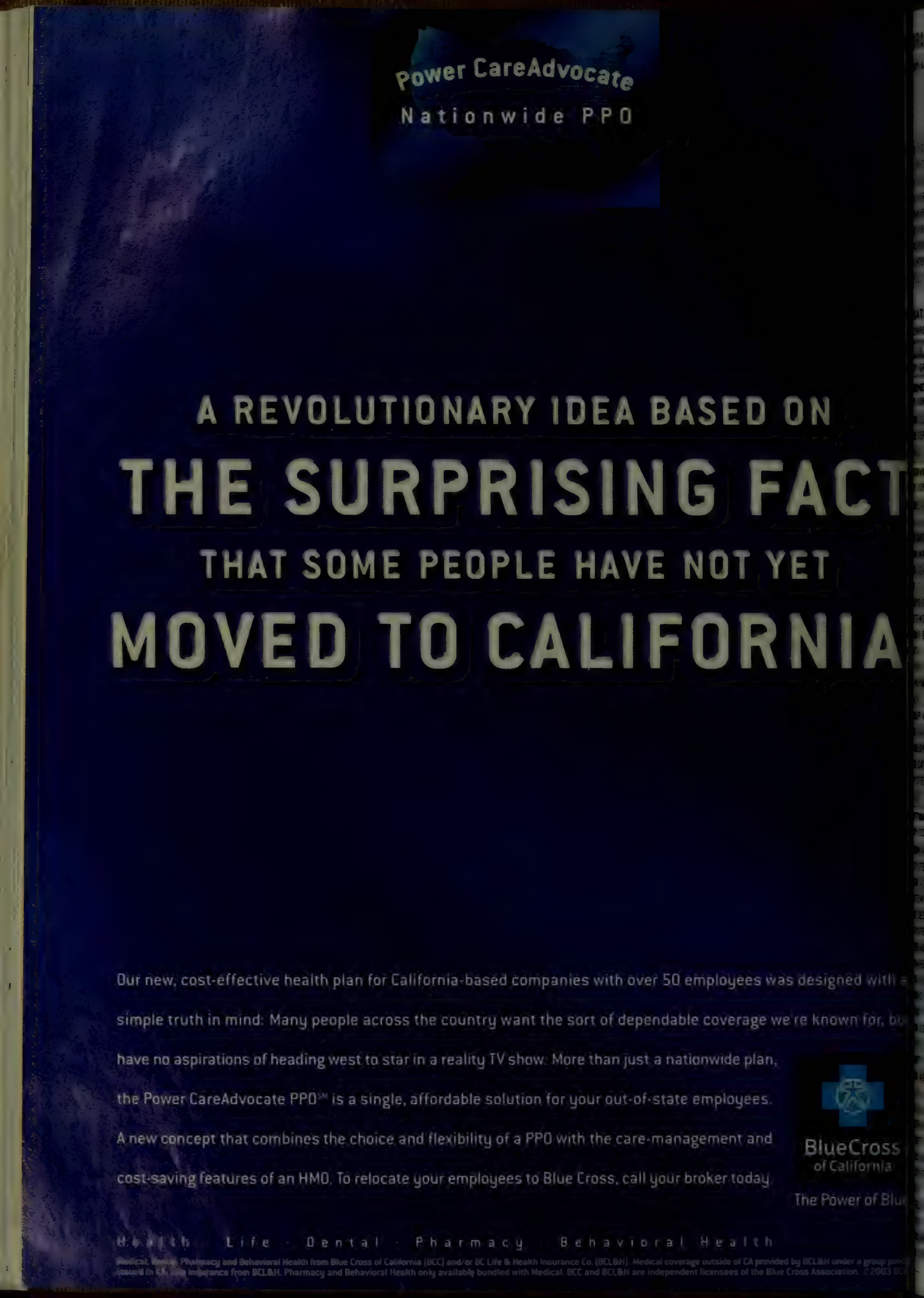
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have no aspirations of heading west to star in a reality TV show. More than just a nationwide plan,
the Power CareAdvocate PPO℠ is a single, affordable solution for your out-of-state employees.
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ORATE SCOREBOARD

ANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY	PRICE–EARNINGS	12 MONTHS' EARNINGS
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	RATIO 7-24	PER SHARE
AR SYSTEM LSTR	390.1	0	755.8	4	13.6	11	23.7	14	3.5	3.1	37.3	19	3.17
K SOUTHERN NSC	1633.0	3	3194.0	5	137.0	15	222.0	8	8.4	7.5	7.0	16	1.22
Y ROAD	741.5	13	1495.6	19	6.6	43	14.5	424	0.9	0.7	11.0	19	2.46
NSPORTATION SCST	208.3	5	408.4	7	3.9	27	5.2	5	1.9	1.6	6.8	18	0.82
RANSPORTATION SWFT	584.9	11	1136.2	13	19.2	6	28.1	4	3.3	3.3	7.8	31	0.71
RESS ENTERPRISES XPRSA	231.9	5	452.6	10	2.2	138	2.3	NM	1.0	0.4	2.4	44	0.29
PACIFIC UNP	3266.0	5	6343.0	9	288.0	–5	443.0	–16	8.8	9.6	11.1	13	4.74
ENTERPRISES WERN	362.3	5	709.5	9	19.9	20	31.7	17	5.5	4.9	9.8	24	1.01
YELL	713.5	10	1394.5	14	18.4	599	24.0	867	2.6	0.4	11.8	17	1.54
MATION TECHNOLOGY													
COMPOSITE	155434.4	8	307098.6	8	5318.0	NM	12870.8	NM	3.4	NM	2.2	NM	0.10
OFTWARE & SERVICES													
TRY GROUP COMPOSITE	36707.0	5	72074.3	4	4524.3	18	9130.8	11	12.3	11.0	13.8	32	0.68
ERNET SOFTWARE & SERVICES													
RY COMPOSITE	939.0	32	1800.4	30	44.0	992	39.9	NM	4.7	0.6	1.9	NM	0.09
INK ELNK	352.3	5	706.0	6	–14.5	NM	–76.4	NM	NM	NM	–24.1	NM	–0.97
RE SERVICES OVER	265.3	74	490.1	66	7.6	–56	18.8	–60	2.9	11.5	11.0	33	0.75
YHOO	321.4	42	604.4	44	50.8	138	97.5	206	15.8	9.5	6.8	NM	0.29
SERVICES													
RY COMPOSITE	17691.7	2	34801.5	1	1104.3	–13	1910.3	–21	6.2	7.3	14.7	26	0.99
URE ACN [4]	3044.8	–9	5871.0	–12	132.1	15	250.9	101	4.3	3.4	57.2	22	0.88
ACXM [9]	236.7	5	476.1	5	11.3	8	–12.5	NM	4.8	4.6	4.1	69	0.23
E DATA SYSTEMS ADS	247.6	20	487.8	17	11.9	250	24.3	208	4.8	1.7	6.6	50	0.55
AN MANAGEMENT SYSTEMS AMSY	232.0	–8	459.0	–9	–46.6	NM	–40.4	NM	NM	0.5	–6.2	NM	–0.57
N CEN	297.8	0	612.4	4	25.4	4	52.1	21	8.5	8.5	8.6	26	0.69
Y CEY	247.4	–3	487.6	–1	23.0	0	35.2	–10	9.3	9.0	34.0	21	1.29
GYS CVG	563.2	–2	1123.6	–3	42.8	–28	77.7	–35	7.6	10.3	10.0	24	0.67
STEMS DST	617.0	5	1236.8	3	53.0	–1	104.4	–7	8.6	9.3	14.6	22	1.67
ONIC DATA SYSTEMS EDS	5522.0	2	10890.0	2	139.0	–55	31.0	–95	2.5	5.7	5.2	27	0.77
ATA FDC	2114.2**	12	4123.2	14	353.8	18	646.4	19	16.7	15.8	31.4	22	1.76
FISV	738.6	17	1446.1	14	78.4	18	152.6	16	10.6	10.5	14.2	26	1.47
PAYMENTS GPN [7]	134.3	11	258.9	10	13.0	158	25.1	64	9.7	4.2	14.9	24	1.41
KEA	203.5	–10	408.2	–9	6.6	20	17.2	55	3.3	2.4	3.2	65	0.20
OUP MPS	278.9	–3	550.7	–6	5.8	39	8.8	43	2.1	1.4	–1.3	NM	–0.09
X PAYX [7]	289.8**	19	577.6	19	71.3	4	142.9	5	24.6	28.1	27.2	38	0.78
HOLDINGS TSG	507.2	–5	1051.0	–3	6.8	–90	71.7	–54	1.3	12.7	7.6	27	0.90
RD DATA SYSTEMS EDS	734.0	19	1408.5	14	89.9	10	165.9	9	12.2	13.1	13.9	21	1.17
YSTEM SERVICES TSS	257.7	7	509.1	8	34.3	14	66.0	15	13.3	12.5	20.5	34	0.68
UIS	1425.0	5	2823.9	4	52.5	24	91.0	21	3.7	3.1	23.9	16	0.73
FTWARE													
RY COMPOSITE	18076.2	7	35472.4	6	3376.0	32	7180.7	24	18.7	15.1	14.0	33	0.64
ION ATVI [9]	158.7	–17	283.7	–20	4.2	–80	–3.8	NM	2.6	10.8	7.9	25	0.46
SYSTEMS ADBE [1]	320.1	1	617.0	5	64.2	18	118.5	14	20.1	17.1	25.5	38	0.86
SK ADSK [11]	210.8	–8	406.3	–16	7.5	–57	13.9	–65	3.6	7.7	3.9	75	0.20
STEMS BEAS [11]	237.3	5	486.6	7	24.5	532	59.5	311	10.3	1.7	13.2	53	0.25
E DESIGN SYSTEMS CDN	276.4	–20	532.3	–23	–7.9	NM	–27.0	NM	NM	NM	4.3	50	0.26
SYSTEMS CTXS	143.0	22	286.5	10	29.3	170	59.7	59	20.5	9.2	17.7	27	0.68
TER ASSOCIATES INTL CA [9]	813.0	5	1614.0	5	10.0	NM	–96.0	NM	1.2	NM	–4.3	NM	–0.33
WARE CPWR [9]	306.0	–12	643.6	–15	2.6	–88	24.0	NM	0.9	6.5	6.2	22	0.23
DS (J.D.) JDEC [2]	203.5	–9	409.4	–4	–0.4	NM	6.1	NM	NM	1.6	11.1	32	0.44
ONIC ARTS ERTS [9]	353.4	5	816.5	2	18.4	148	27.6	–50	5.2	2.2	17.2	37	2.21
AAC FIC [3]	163.0	79	321.6	81	30.0	109	55.7	95	18.4	15.8	5.7	60	0.93
ON SOLUTIONS HYSL [6]	138.0	2	264.5	3	9.2	47	17.4	87	6.6	4.6	8.6	27	0.96
INTU [5]	634.7	20	1192.8	23	223.0	58	348.3	60	35.1	27.0	9.8	39	1.08
SOFT MSFT [6]	8065.0	11	15900.0	10	1921.0	26	4715.0	11	23.8	21.0	16.4	28	0.92
RK ASSOCIATES NET	216.6	–7	431.8	–5	1.1	–95	–2.6	NM	0.5	9.1	6.0	88	0.30
NOVL [2]	276.0	1	535.9	–3	–28.6	NM	–40.5	NM	NM	NM	–11.8	NM	–0.33
ORCL [7]	2832.0	2	5139.0	3	858.0	31	1429.0	23	30.3	23.6	36.5	27	0.43
ETRIC TECHNOLOGY PMTC [3]	165.2	–7	336.3	–6	–33.8	NM	–48.9	NM	NM	NM	–43.7	NM	–0.39
SOFT PSFT	497.4	3	957.7	–1	36.5	1	75.0	–7	7.3	7.5	8.4	30	0.55
LDS & REYNOLDS REY [3]	250.4	0	505.5	2	28.2	–7	57.8	–3	11.3	12.1	25.7	17	1.65
SYSTEMS SEBL	333.3	–18	666.1	–25	9.8	–67	14.4	–85	2.9	7.3	–5.7	NM	–0.23
SY	192.0	–6	373.6	–10	14.6	–28	27.5	–24	7.6	9.8	4.8	51	0.30
TEC SYMC [9]	391.1	24	781.2	25	68.2	21	136.4	122	17.4	17.9	13.3	29	1.59
SYS SNPS [2]	292.0	57	560.2	55	22.3	4	56.7	60	7.6	11.5	–14.9	NM	–2.50
WO INTERACTIVE SOFTWARE TTWO [2]	194.2	14	603.0	33	15.2	55	65.7	48	7.8	5.7	20.9	12	2.21
S SOFTWARE VRTS	412.9	13	807.2	10	48.7	87	91.3	29	11.8	7.1	2.3	NM	0.18

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY	PRICE-EARNINGS
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	RATIO 7-24
20 SEMICONDUCTORS & SEMICONDUCTOR EQUIPMENT												
INDUSTRY GROUP COMPOSITE	**16756.0**	**5**	**33211.1**	**5**	**-354.3**	**NM**	**-425.9**	**NM**	**NM**	**NM**	**-5.2**	**NM**
ADVANCED MICRO DEVICES AMD	645.3	7	1359.8	-9	-140.1	NM	-286.5	NM	NM	NM	-61.1	NM
AGERE SYSTEMS AGR.A [3]	456.0	-8	899.0	-9	-67.0	NM	-245.0	NM	NM	NM	NM	NM
ALTERA ALTR	205.3	15	400.3	14	36.1	66	66.2	63	17.6	12.1	9.9	60
ANALOG DEVICES ADI [2]	501.9	21	969.3	20	71.3	394	131.3	236	14.2	3.5	6.5	71
APPLIED MATERIALS AMAT [2]	1107.2	-4	2161.4	0	-62.1	NM	-127.8	NM	NM	4.5	1.7	NM
ATMEL ATML	318.5	1	615.0	4	-44.1	NM	-97.2	NM	NM	NM	-22.8	NM
BROADCOM BRCM	377.9	46	705.3	42	-831.7	NM	-899.6	NM	NM	NM	NM	NM
CYPRESS SEMICONDUCTOR CY	203.1	0	384.1	-3	-12.4	NM	-45.8	NM	NM	NM	-45.2	NM
FAIRCHILD SEMICONDUCTOR INTL. FCS	347.1	-4	698.2	0	-63.8	NM	-81.4	NM	NM	NM	-6.5	NM
INTEL INTC	6816.0	8	13567.0	4	896.0	101	1811.0	31	13.1	7.1	10.0	44
LINEAR TECHNOLOGY LLTC [6]	165.8	18	319.5	18	66.0	20	126.6	19	39.8	39.1	13.0	48
LSI LOGIC LSI	407.2	-7	780.0	-8	-162.1	NM	-284.5	NM	NM	NM	-16.9	NM
MICROCHIP TECHNOLOGY MCHP [9]	161.3	2	320.9	5	13.5	-35	46.5	-1	8.4	13.2	7.7	55
MICRON TECHNOLOGY MU [4]	732.7	-5	1517.7	7	-214.9	NM	-834.1	NM	NM	NM	-34.3	NM
NATIONAL SEMICONDUCTOR NSM [7]	425.3	1	829.6	5	-4.4	NM	-40.8	NM	NM	4.1	-2.0	NM
NOVELLUS SYSTEMS NVLS	239.1	8	477.5	22	7.4	-38	19.3	22	3.1	5.4	1.2	NM
NVIDIA NVDA [11]	405.0	-31	873.9	-20	19.7	-76	70.7	-56	4.9	14.3	2.8	NM
QLOGIC QLGC [9]	126.2	28	246.8	30	31.7	37	61.6	48	25.1	23.3	14.2	28
RF MICRO DEVICES RFMD [9]	131.5	27	269.9	32	-8.1	NM	-21.1	NM	NM	2.3	-3.6	NM
TERADYNE TER	331.5	7	666.1	19	-52.5	NM	-129.0	NM	NM	NM	-75.8	NM
TEXAS INSTRUMENTS TXN	2339.0	8	4531.0	14	121.0	27	238.0	318	5.2	4.4	-1.5	NM
XILINX XLNX [9]	313.3	8	618.8	10	46.2	13	95.7	27	14.8	14.1	6.5	68
21 TECHNOLOGY HARDWARE & EQUIPMENT												
INDUSTRY GROUP COMPOSITE	**101971.4**	**10**	**201813.2**	**10**	**1148.0**	**NM**	**4165.9**	**NM**	**1.1**	**NM**	**-2.5**	**NM**
(A) COMMUNICATIONS EQUIPMENT												
INDUSTRY COMPOSITE	18388.3	-10	37196.3	-9	754.2	NM	1315.4	NM	4.1	NM	-5.2	NM
ADC TELECOMMUNICATIONS ADCT [2]	191.9	-36	391.8	-34	-29.4	NM	-70.9	NM	NM	NM	NM	NM
AUDIOVOX VOXX [1]	301.0	1	597.8	24	2.1	-44	3.3	NM	0.7	1.2	-3.6	NM
AVAYA AV [3]	1072.0	-12	2153.0	-14	8.0	NM	-33.0	NM	0.7	NM	NM	NM
BLACK BOX BBOX [9]	128.3	-17	263.2	-16	11.5	-22	15.7	-43	9.0	9.5	9.2	17
BROCADE COMMUNICATIONS SYSTEMS BRCD [2]	130.9	-3	254.1	-2	-146.0	NM	-152.9	NM	NM	10.4	-17.6	NM
CISCO SYSTEMS CSCO [5]	4618.0	-4	9331.0	-3	987.0	35	1978.0	42	21.4	15.1	12.2	40
COMVERSE TECHNOLOGY CMVT [11]	180.6	-15	356.6	-25	-5.8	NM	-36.0	NM	NM	NM	-7.2	NM
CORNING GLW †	752.0**	-9	1498.0	-10	-22.0	NM	-227.0	NM	NM	NM	-35.6	NM
HARRIS HRS [6]	579.7	16	1118.6	14	0.7	-97	23.3	-53	0.1	5.3	5.0	35
JUNIPER NETWORKS JNPR	165.1	41	322.3	35	13.6	118	17.3	NM	8.2	5.3	-4.2	NM
LUCENT TECHNOLOGIES LU [3]	1965.0	-33	4368.0	-32	-254.0	NM	-605.0	NM	NM	NM	NM	NM
MOTOROLA MOT	6163.0	-10	12206.0	-6	119.0	NM	288.0	NM	1.9	NM	4.8	35
QUALCOMM QCOM [3]	921.6	20	1964.7	34	191.7	NM	294.7	877	20.8	NM	10.1	42
SCIENTIFIC-ATLANTA SFA [6]	404.2	4	786.8	-7	47.4	NM	74.2	164	11.7	NM	5.8	46
TELLABS TLAB	234.1	-32	456.6	-36	-110.7	NM	-153.6	NM	NM	NM	-14.7	NM
3COM COMS [7]	175.0	-41	391.5	-40	-98.2	NM	-177.4	NM	NM	1.6	-13.4	NM
UTSTARCOM UTSI	405.8	75	736.4	77	39.4	53	76.8	77	9.7	11.1	19.0	35
(B) COMPUTERS & PERIPHERALS												
INDUSTRY COMPOSITE	63014.5	20	124006.4	20	3403.2	217	6162.3	83	5.4	2.0	7.1	55
APPLE COMPUTER AAPL [3]	1545.0	8	3020.0	8	19.0	-41	33.0	-54	1.2	2.2	-0.4	NM
DELL COMPUTER DELL [11]	9532.0	18	19267.0	19	598.0	31	1201.0	32	6.3	5.7	44.6	38
DIEBOLD DBD	480.9	-1	891.0	1	41.3	4	67.2	1	8.6	8.2	12.9	24
EMC EMC	1479.3	7	2863.5	6	81.7	NM	116.9	NM	5.5	0.1	1.0	NM
GATEWAY GTW	799.6	-20	1644.1	-18	-69.8	NM	-267.5	NM	NM	NM	-46.5	NM
HEWLETT-PACKARD HPQ [2]	17983.0	69	35860.0	63	659.0	162	1380.0	88	3.7	2.4	-0.7	NM
IMATION IMN	268.0	3	541.3	2	18.9	-6	40.4	13	7.1	7.7	9.9	17
INFOCUS INFS	134.3	-19	279.4	-13	-40.2	NM	-52.6	NM	NM	0.7	-39.1	NM
INTERNATIONAL BUSINESS MACHINES IBM	21631.0	10	41696.0	11	1725.0	280	3112.0	80	8.0	2.3	25.3	21
LEXMARK INTERNATIONAL LXK	1120.2	5	2228.1	5	101.7	14	196.3	22	9.1	8.4	29.8	20
MAXTOR MXO	910.9	5	1849.8	-4	6.2	NM	33.6	NM	0.7	NM	-11.2	NM
NCR NCR	1366.0	-1	2600.0	-1	9.0	-65	-18.0	NM	0.7	1.9	6.1	36
NETWORK APPLIANCE NTAP [8]	241.6	18	470.1	17	24.8	219	44.5	202	10.3	3.8	7.7	51
PALM PALM [7]	225.8	-3	434.8	-17	-15.0	NM	-187.4	NM	NM	NM	NM	NM
SANDISK SNDK	234.6	54	409.1	55	41.3	357	66.3	NM	17.6	7.1	13.8	43
SEAGATE TECHNOLOGY STX [6]	1553.0	5	3173.0	0	160.0	NM	334.0	NM	10.3	NM	48.7	14
STORAGE TECHNOLOGY STK	527.3	7	1007.2	6	30.1	57	46.6	86	5.7	3.9	10.6	22
SUN MICROSYSTEMS SUNW [6]	2982.0	-13	5772.0	-12	12.0	-80	16.0	-33	0.4	1.8	-31.5	NM
(C) ELECTRONIC EQUIPMENT & INSTRUMENTS												
INDUSTRY COMPOSITE	19282.1	3	38047.1	2	-3025.5	NM	-3365.9	NM	NM	NM	-36.1	NM
AGILENT TECHNOLOGIES A [2]	1467.0	1	2879.0	0	-146.0	NM	-258.0	NM	NM	NM	-17.0	NM

ORATE SCOREBOARD

LNY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY	PRICE-EARNINGS	12 MONTHS' EARNINGS
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	RATIO 7-24	PER SHARE
IGL APH	304.9	13	582.7	11	19.5	-3	42.8	15	6.4	7.4	39.3	28	1.99
ELECTRONICS ARW	2123.1	15	4103.2	11	6.8	NM	5.9	123	0.3	0.0	1.1	NM	0.16
ARK ELECTRONICS BHE	448.9	11	897.4	22	11.8	42	29.1	114	2.6	2.0	9.5	19	2.00
WC	1075.3	2	2092.9	2	43.6	-1	86.0	1	4.1	4.2	19.2	22	2.15
R CLST [1]	436.1	-22	928.6	-21	-8.1	NM	-6.3	NM	NM	NM	-24.9	NM	-3.97
OINT SYSTEMS CKP	175.7	2	332.1	2	10.9	82	15.1	49	6.2	3.7	11.9	17	0.88
IMAGING SYSTEMS GISX [6]	180.2	17	363.3	20	4.3	-44	13.4	-13	2.4	5.0	13.1	18	1.41
ST	189.7	-6	368.6	-2	1.1	49	-0.6	NM	0.6	0.4	10.6	12	0.79
RCUIT JBL [4]	1219.3	43	2365.2	41	4.5	-79	14.6	-41	0.4	2.4	1.6	NM	0.12
MOLX [5]	476.1	4	919.2	5	2.0	-93	26.8	-43	0.4	6.0	4.5	67	0.44
R PMTR [6]	145.5	-5	312.3	5	-11.0	NM	-12.7	NM	NM	NM	-16.4	NM	-0.65
LMER PKI	377.1	-2	735.6	1	10.7	76	14.0	NM	2.8	1.6	1.9	72	0.20
A-SCI SANM [3]	2648.9	1	5092.5	1	-12.2	NM	-44.0	NM	NM	NM	-78.1	NM	-5.20
RON SLR [4]	2815.5	-7	5633.1	-6	-3101.2	NM	-3212.0	NM	NM	NM	NM	NM	-7.18
ATA TECD [11]	3913.9	0	7924.9	-2	21.5	-39	-281.5	NM	0.6	0.9	-15.2	NM	-3.82
TROL TNL	125.7	18	248.3	24	6.0	NM	8.7	NM	4.8	NM	3.4	43	0.42
NIX TEK [7]	202.3	0	385.1	-3	4.3	-36	7.6	-60	2.1	3.3	4.4	52	0.40
ELECTRON TMO	516.4	1	1016.6	0	53.1	7	84.5	-25	10.3	9.7	7.6	22	0.99
VARI [3]	208.7	5	413.3	7	10.7	-18	24.6	0	5.1	6.6	11.8	23	1.48
WAT	231.8	7	452.8	8	42.1	11	76.1	4	18.2	17.5	25.7	25	1.18
FICE ELECTRONICS													
RY COMPOSITE	1286.5	-4	2563.4	-4	16.1	-58	54.0	-23	1.3	2.9	7.5	10	0.73
SCIENTIFIC GRB [8]	135.7**	8	257.7	6	1.5	NM	2.9	NM	1.1	NM	8.7	21	0.37
FICE SOLUTIONS IKN [3]	1150.8	-6	2305.7	-5	14.7	-66	51.1	-35	1.3	3.5	7.4	9	0.79
IALS													
COMPOSITE	**66269.8**	**4**	**128454.1**	**5**	**2107.9**	**33**	**2815.8**	**23**	**3.2**	**2.5**	**4.0**	**61**	**0.47**
MATERIALS													
TRY GROUP COMPOSITE	**66269.8**	**4**	**128454.1**	**5**	**2107.9**	**33**	**2815.8**	**23**	**3.2**	**2.5**	**4.0**	**51**	**0.47**
EMICALS													
RY COMPOSITE	20995.4	9	41115.1	14	998.0	122	1431.4	63	4.8	2.3	7.3	44	0.73
AGLE ALB	269.5	7	535.0	10	22.6	8	45.8	22	8.4	8.2	14.0	14	1.96
CBT [3]	468.0	20	934.0	26	-8.0	NM	15.0	-66	NM	4.6	6.6	27	1.02
NDUSTRIES CYT	374.9	7	742.2	11	25.4	19	54.3	91	6.8	6.1	15.3	14	2.63
EMICAL DOW	8242.0**	14	16323.0	20	393.0	65	478.0	73	4.8	3.3	-2.6	NM	-0.23
N CHEMICAL EMN	1481.0	5	2922.0	11	35.0	-20	53.0	-22	2.4	3.2	5.0	40	0.84
ECL	946.7	13	1822.6	12	67.2	30	122.5	38	7.1	6.2	19.6	27	0.93
(H.B.) FUL [1]	324.5	2	619.1	1	9.8	23	13.0	51	3.0	2.5	6.9	20	1.13
W.R.) GRA	503.4	7	948.2	7	6.5	-69	4.2	-87	1.3	4.5	NM	NM	-0.11
AKES CHEMICAL GLK	416.7	2	750.7	5	16.9	-24	17.8	-35	4.1	5.4	4.8	28	0.75
BAL IGL	538.7	-8	1090.8	0	22.1	230	-9.6	NM	4.1	1.1	-5.8	NM	-0.31
ATIONAL FLAVORS & FRAGRANCES IFF	482.5	1	948.8	3	51.4	13	83.4	-5	10.7	9.5	26.3	16	1.84
L LZ	514.7	1	1022.9	5	29.4	-15	55.4	-14	5.7	6.8	12.6	14	2.27
LL CHEMICAL LYO	913.0	5	1902.0	25	-68.0	NM	-181.0	NM	NM	0.2	-23.9	NM	-1.62
A SOLUTIONS OMN [1]	176.6	1	330.0	0	-5.0	NM	-11.9	NM	NM	3.1	-7.9	NM	-0.27
USTRIES PPG	2304.0	5	4375.0	8	152.0	NM	236.0	NM	6.6	NM	19.7	19	2.80
R PX	1401.0	7	2738.0	8	150.0	0	280.0	1	10.7	11.5	19.1	18	3.35
AN (A.) SHLM [4]	298.4	15	566.6	20	2.4	-80	7.1	-56	0.8	4.5	6.4	18	0.87
ALDRICH SIAL	327.1	7	661.8	9	48.0	12	96.9	13	14.7	14.1	20.3	20	2.74
CH SEH [2]	250.5	7	464.2	10	10.5	16	16.7	20	4.2	3.9	12.1	17	1.26
SCL	200.4	5	387.5	5	4.8	-42	7.0	-41	2.4	4.4	9.9	16	1.55
R VAL [2]	561.8	1	1030.7	5	32.2	-7	47.8	1	5.7	6.2	15.2	18	2.34
NSTRUCTION MATERIALS													
RY COMPOSITE	825.8	3	1510.3	0	37.5	-44	48.1	-51	4.5	8.4	6.5	22	1.72
N INTERNATIONAL AMN [1]	147.8	7	278.5	8	7.8	5	10.0	7	5.3	5.5	12.4	9	3.57
CONSTRUCTION PRODUCTS CXP [9]	143.7	12	260.4	8	14.2	-15	23.6	-14	9.9	13.0	11.1	14	2.98
A ROCK INDUSTRIES FRK [3]	198.1	4	361.7	0	23.0	19	39.3	24	11.6	10.2	13.1	18	2.51
INDUSTRIES TXI [7]	336.1**	-2	609.8	-6	-7.6	NM	-24.8	NM	NM	6.8	-3.3	NM	-1.15
NTAINERS & PACKAGING													
RY COMPOSITE	11835.9	8	22482.5	7	560.6	14	782.8	74	4.7	4.5	6.8	35	0.65
USTRIES AEPI [2]	191.0	19	360.8	17	-3.4	NM	-7.6	NM	NM	1.1	-27.8	NM	-2.17
ROUP ATR	288.1	24	553.2	22	21.3	22	40.6	32	7.4	7.5	11.1	18	2.10
L	1353.3	31	2424.2	27	74.3	49	105.8	37	5.5	4.8	29.9	15	3.28
BMS	670.2	15	1308.7	15	38.8	-12	74.3	-6	5.8	7.5	15.3	15	2.99
PEAKE CSK	212.7	13	430.2	16	9.4	NM	12.1	NM	4.4	0.2	6.4	10	2.15
HOLDINGS CCK	1726.0	-4	3186.0	-5	72.0	13	38.0	280	4.2	3.6	NM	NM	-1.03
C PACKAGING INTERNATIONAL GPK	275.0	4	535.9	2	1.7	-38	1.7	NM	0.6	1.1	-2.5	NM	-0.16
EF [2]	423.6	7	810.0	5	-5.1	NM	-5.7	NM	NM	1.7	2.6	34	0.64

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY	PRICE-EARNINGS RATIO
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %	12 MONTHS ENDING 6-30	7-24
LONGVIEW FIBRE LFB [2]	181.6	–1	371.2	3	0.5	NM	1.9	NM	0.3	0.0	3.0	32
OWENS-ILLINOIS OI	1579.6	5	2966.0	6	17.0	–82	51.4	NM	1.1	6.5	14.0	9
PACKAGING CORP. OF AMERICA PKG	436.5	–2	859.7	0	10.7	–8	17.8	–16	2.5	2.6	5.6	45
PACTIV PTV	810.0	11	1527.0	11	59.0	–2	103.0	1	7.3	8.2	21.9	14
ROCK-TENN RKT [3]	386.4	8	753.8	7	7.2	32	14.5	–15	1.9	1.5	5.2	23
SEALED AIR SEE	865.5	10	1688.4	10	65.3	0	127.5	1	7.6	8.4	–40.3	NM
SILGAN HOLDINGS SLGN	545.2	20	999.6	14	13.5	34	17.7	–17	2.5	2.2	57.2	12
SONOCO PRODUCTS SON	709.3	0	1390.8	2	22.8	–39	51.8	–27	3.2	5.3	12.4	19
TEMPLE-INLAND TIN	1182.0	–1	2317.0	5	155.0	869	138.0	345	13.1	1.3	8.9	13
(D) METALS & MINING												
INDUSTRY COMPOSITE	12738.4	8	24747.0	9	192.0	–52	339.8	–33	1.5	3.4	1.8	NM
AK STEEL HOLDING AKS	1021.4	–11	2023.8	–4	–78.2	NM	–119.0	NM	NM	2.1	NM	NM
ALCOA AA	5460.0	6	10572.0	8	227.0	–4	422.0	0	4.2	4.6	4.9	44
ALLEGHENY TECHNOLOGIES ATI	489.9	0	970.4	–1	–26.0	NM	–51.8	NM	NM	NM	–25.2	NM
ARCH COAL ACI	390.9	4	729.4	–2	–1.5	NM	–14.6	NM	NM	0.6	–2.3	NM
COMMERCIAL METALS CMC [4]	774.1	19	1435.0	17	3.0	–82	6.0	–74	0.4	2.5	3.5	30
COMMONWEALTH INDUSTRIES CMIN	215.1	–15	427.1	–10	–1.9	NM	–8.4	NM	NM	0.4	4.1	13
FREEPORT-McMoRAN COPPER & GOLD FCX	609.5	49	1134.1	42	66.9	345	116.7	304	11.0	3.7	NM	18
NUCOR NUE	1520.5	27	3000.7	32	8.4	–86	26.2	–67	0.6	5.0	4.7	36
PEABODY ENERGY BTU	693.2**	6	1374.5	3	–1.3	NM	–2.2	NM	NM	3.7	5.2	31
QUANEX NX [2]	254.6	2	484.1	7	9.4	–12	16.1	0	3.7	4.3	13.2	9
SCHNITZER STEEL INDUSTRIES SCHN [4] †	127.9	34	252.6	45	15.0	346	23.4	913	11.7	3.5	10.5	14
STEEL DYNAMICS STLD	218.6	8	454.1	19	5.4	–69	21.2	10	2.5	8.3	14.9	8
STEEL TECHNOLOGIES STTX [3]	129.6	1	259.7	7	1.0	–80	3.0	–62	0.8	3.9	9.4	8
WEIRTON STEEL WRTLQ	243.1	–3	503.0	3	–51.0	NM	–125.8	NM	NM	NM	NM	NM
WORTHINGTON INDUSTRIES WOR [7]	589.9	14	1126.5	22	15.6	–42	26.9	NM	2.6	5.2	11.8	16
(E) PAPER & FOREST PRODUCTS												
INDUSTRY COMPOSITE	19874.3	–5	38599.1	–4	319.8	80	213.8	–38	1.6	0.8	0.6	NM
BOISE CASCADE BCC	1929.0	2	3782.2	3	–3.9	NM	–22.7	NM	NM	0.2	–1.7	NM
BOWATER BOW	664.1	3	1294.6	2	–25.7	NM	–95.3	NM	NM	NM	–11.2	NM
GEORGIA-PACIFIC GP	5048.0	–19	9615.0	–20	62.0	NM	6.0	NM	1.2	NM	–3.5	NM
GLATFELTER GLT	132.4	–5	277.0	2	0.7	–91	27.4	40	0.5	5.4	11.7	12
INTERNATIONAL PAPER IP	6264.0	–1	12339.0	0	88.0	–59	142.0	–49	1.4	3.4	2.0	NM
POTLATCH PCH	368.1	5	702.9	7	0.8	NM	–2.1	NM	1.9	NM	–7.5	NM
RAYONIER RYN	295.9	10	561.8	4	31.7	80	39.9	90	10.7	6.5	9.3	22
WAUSAU-MOSINEE PAPER WMO	242.8	2	482.7	4	3.2	–43	4.6	–50	1.3	2.4	5.3	33
WEYERHAEUSER WY	4930.0	0	9544.0	7	157.0	118	114.0	12	3.2	1.5	3.8	40
TELECOMMUNICATION SERVICES												
SECTOR COMPOSITE	**53272.3**	**0**	**106095.2**	**2**	**4517.6**	**NM**	**10889.5**	**530**	**8.5**	**NM**	**15.4**	**14**
23 TELECOMMUNICATION SERVICES												
INDUSTRY GROUP COMPOSITE	**53272.3**	**0**	**106095.2**	**2**	**4517.6**	**NM**	**10889.5**	**530**	**8.5**	**NM**	**15.4**	**14**
(A) DIVERSIFIED TELECOMMUNICATION SERVICES												
INDUSTRY COMPOSITE	44876.1	–2	89794.7	0	3869.9	594	10039.1	209	8.6	1.2	19.1	12
ALLTEL AT	2010.3	18	3916.1	18	224.2	17	451.8	17	11.2	11.3	14.2	15
AT&T T	8795.0	–8	17781.0	–7	536.0	–11	1065.0	139	6.1	6.3	7.4	16
BELLSOUTH BLS	5642.0	–2	11165.0	–1	951.0	262	1866.0	34	16.9	4.6	16.4	16
IDT IDT.C [5]	454.9	13	905.6	17	–9.3	NM	–21.8	NM	NM	NM	–12.0	NM
LEVEL 3 COMMUNICATIONS LVLT	941.0	25	2171.0	91	–453.0	NM	–341.0	NM	NM	NM	NM	NM
SBC COMMUNICATIONS SBC †	10204.0	–6	20537.0	–4	1388.0	–22	3843.0	13	13.6	16.4	20.5	10
VERIZON COMMUNICATIONS VZ	16829.0	0	33319.0	1	1233.0	NM	3176.0	NM	7.3	NM	23.3	10
(B) WIRELESS TELECOMMUNICATION SERVICES												
INDUSTRY COMPOSITE	8396.2	12	16300.6	13	647.7	NM	850.5	NM	7.7	NM	1.1	NM
AT&T WIRELESS SERVICES AWE	4158.0	6	8106.0	8	228.0	NM	370.0	NM	5.5	NM	–8.9	NM
CENTENNIAL COMMUNICATIONS CYCL [7]	191.1	0	373.1	1	61.4	NM	–98.2	NM	32.1	NM	NM	NM
NEXTEL COMMUNICATIONS NXTL	2556.0	19	4927.0	20	309.0	151	549.0	NM	12.1	5.7	64.0	8
TELEPHONE & DATA SYSTEMS TDS	851.3	18	1658.7	20	20.2	NM	15.2	NM	2.4	NM	–1.1	NM
U.S. CELLULAR USM	639.8	22	1235.7	23	29.1	NM	14.5	NM	4.6	NM	1.7	59
UTILITIES												
SECTOR COMPOSITE	**18363.6**	**15**	**40853.4**	**24**	**1104.5**	**–11**	**2981.7**	**10**	**6.0**	**7.7**	**11.3**	**14**
24 UTILITIES												
INDUSTRY GROUP COMPOSITE	**18363.6**	**15**	**40853.4**	**24**	**1104.5**	**–11**	**2981.7**	**10**	**6.0**	**7.7**	**11.3**	**14**
(A) ELECTRIC UTILITIES												
INDUSTRY COMPOSITE	15702.1	17	33541.3	23	863.3	–17	2265.6	6	5.5	7.7	10.8	14
CH ENERGY GROUP CHG	183.2	20	450.4	29	8.1	299	28.7	29	4.4	1.3	8.9	16
CINERGY CIN	933.9	3	2201.9	17	76.5	66	217.1	54	8.2	5.1	13.1	13

ORATE SCOREBOARD

NY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE–EARNINGS RATIO 7-24	12 MONTHS' EARNINGS PER SHARE
	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 $ MIL.	CHANGE FROM 2002 %	6 MONTHS 2003 $ MIL.	CHANGE FROM 2002 %	2ND QUARTER 2003 %	2ND QUARTER 2002 %			
DATED EDISON ED	2175.0	18	4746.0	22	69.0	–32	226.0	–17	3.2	5.5	10.4	14	2.90
N RESOURCES D	2604.0	12	6189.0	25	240.0	–12	748.0	26	9.2	11.7	13.5	12	5.05
JP FPL	2459.0	16	4632.0	19	243.0	–4	421.0	0	9.9	11.9	10.7	16	3.92
AINS ENERGY GXP	503.2	12	967.9	22	58.3	61	74.1	115	11.6	8.1	18.0	11	2.56
N ELECTRIC INDUSTRIES HE	448.8	10	873.4	11	26.3	–18	51.1	–14	5.9	7.8	10.5	15	2.97
AST UTILITIES NU	1457.5	28	3146.0	30	28.3	–7	89.9	79	1.9	2.6	8.7	11	1.50
ST	647.9	9	1411.5	9	39.6	597	82.5	104	6.1	1.0	15.5	12	3.82
S ENERGY PGN	2012.7	3	4028.7	8	150.3	23	347.2	41	7.5	6.2	9.4	14	2.86
NERGY PSD	557.9	8	1233.8	–4	22.4	–29	67.1	16	4.0	5.8	7.7	17	1.29
ERGY TE	737.2	9	1395.7	9	–101.9	NM	–121.2	NM	NM	11.9	1.0	84	0.15
SOURCES WPS	981.8	196	2265.1	210	3.5	–84	34.1	–34	0.4	6.8	11.5	14	2.85
UTILITIES													
Y COMPOSITE	1427.4	10	4295.7	47	137.7	14	411.5	21	9.6	9.3	13.2	17	2.69
MORGAN KMI †	251.9	10	570.7	13	94.2	30	205.3	28	37.4	33.9	13.9	19	2.87
SEY RESOURCES NJR [3]	369.7	–16	1521.8	57	4.5	–6	45.7	15	1.2	1.1	15.7	14	2.42
ENERGY PGL [3]	398.1	15	1302.0	50	8.0	500	71.5	27	2.0	0.4	12.1	15	2.90
NT NATURAL GAS PNY [2]	407.8	39	901.3	55	31.0	–26	89.0	7	7.6	14.2	10.3	19	2.05
TH-UTILITIES & UNREGULATED POWER													
Y COMPOSITE	1234.1	1	3016.4	9	103.4	30	304.7	27	8.4	6.5	14.7	14	2.29
N EGN	184.0	34	493.7	30	24.5	91	77.8	50	13.3	9.3	15.4	12	2.75
LE RESOURCES EQT	218.5	–4	560.8	6	31.4	8	95.9	18	14.4	12.9	18.7	15	2.63
SOURCES GROUP MDU	548.2	14	1016.0	18	43.5	75	71.2	47	7.9	5.2	13.3	14	2.33
N VVC	283.4	–25	945.9	–6	4.1	–67	59.8	3	1.4	3.3	12.4	13	1.70

ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

oratories 15b
ie & Fitch 5d
tries 17
19b
19c
5f
nds 16d
b
omm. 21a
tems 19c
Marketing 5a
Micro 20
CS 14b

ines 22c

tems 20
chnologies 21c
lolding 22d
Group 18b
ernational 16f
22a
ulver 8b
s 6

Tech. 22d
15b
Data Sys. 19b
2

15b

up 7c
com 5b
perty 13
hemical 12
West Holdings 18b
Axle & Mfg. 1a
Eagle Outfitters 5d
Greetings 2a
Intl. Group 12
Mgmt. Sys. 19b
Skiing 3
Standard 16b
Woodmark 16b

AmerisourceBergen 14b
Ameritrade Holding 11a
Ameron Intl. 22b
Ametek 16d
Amgen 15a
Amphenol 21c
AMR 18b
AmSouth Bancorporation 10a
Analog Devices 20
Andersons 5a
Anheuser-Busch 7a
AnnTaylor Stores 5d
AOL Time Warner 4
Apache 9b
Apogee Enterprises 16b
Apogent Technologies 14a
Apollo Group 17
Apple Computer 21b
Applied Biosystems 14a
Applied Materials 20
Apria Healthcare Group 14b
AptarGroup 22c
Arch Coal 22d
Archer Daniels 7b
Arkansas Best 18d
Arrow Electronics 21c
ArvinMeritor 1a
Ashland 9b
Associated Banc-Corp 10a
Astoria Financial 10b
AT&T 23a
AT&T Wireless 23b
Atmel 20
Autodesk 19c
Autoliv 1a
AutoNation 5d
AutoZone 5d
AvalonBay Communities 13
Avaya 21a
Avery Dennison 17
Avon Products 8b
Aztar 3

B

Baker Hughes 9a
Baldor Electric 16d
Ball 22c
BancorpSouth 10a
Bandag 1a
Bank of America 10a
Bank of New York 11a
Bank One 10a
Banknorth Group 10a
Bard (C.R.) 14a
Barnes & Noble 5d
Barnes Group 16f
Bausch & Lomb 14a
Baxter International 14a
BB&T 10a
B/E Aerospace 16a
BEA Systems 19c
Bear Stearns 11a
Beazer Homes USA 2a
Becton, Dickinson 14a
Bed Bath & Beyond 5d
Belden 16d
BellSouth 23a
Bemis 22c
Benchmark Electronics 21c
Berkley (W.R.) 12
Best Buy 5d
Big Lots 5c
Biogen 15a
Biomet 14a
BJ Services 9a
BJ's Wholesale Club 6
Black & Decker 2a
Black Box 21a
BlackRock 11a
Blair 5b
Block (H&R) 17
Blockbuster 5d
Blyth 2a
Bob Evans Farms 3
Boeing 16a
Boise Cascade 22e
BOK Financial 10a
Bon-Ton Stores 5c
Borders Group 5d
BorgWarner 1a
Boston Properties 13
Boston Scientific 14a
Bowater 22c
Brady 16d
Bristol-Myers Squibb 15b
Broadcom 20
Brocade Communications 21a
Brown & Brown 12
Brown Shoe 2c
Brown-Forman 7a
Brunswick 2b
Burlington Northern Santa Fe 18d
Burlington Resources 9b

C

Cabot 22a
Cadence Design Systems 19c
Callaway Golf 2b
Campbell Soup 7b
Capital One Financial 11b
Career Education 17
Carlisle 16e
CarMax 5d
Carnival 3
Casey's General Stores 6
Caterpillar 16f
Cato 5d
CBRL Group 3
CDI 17
CDW 21c
CEC Entertainment 3
CellStar 21c
Cendant 17
Centennial Commun. 23b
Centex 2a
Centex Construction Prods. 22b
Ceridian 19b
Cerner 14b
Certegy 19b
CH Energy Group 24a
Champion Enterprises 2a
Charming Shoppes 5d
Charter One Financial 10a
Checkpoint Systems 21c
Cheesecake Factory 3
Chesapeake 22c
Chicago Mercantile Exchg. 11c
Chico's FAS 5d
Children's Place 5d
Chiron 15a
ChoicePoint 17
Churchill Downs 3
CINergy 24a
Cintas 17
Circuit City Stores 5d
Cisco Systems 21a
CIT Group 11c
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Coca-Cola 7a
Coca-Cola Bottling 7a
Coca-Cola Enterprises 7a
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Colonial BancGroup 10a
Columbia Sportswear 2c
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Commercial Metals 22d
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Dollar General 5c
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Elizabeth Arden 8b
EMC 21b
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Energen 24c
Engineered Support Sys. 16a
ENSCO International 9a
Equifax 17
Equitable Resources 24c
Esterline Technologies 16a
Everest Re Group 12
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FMC Technologies 9a
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Ford Motor 1b
Forest City Ent. 13
Forest Laboratories 15b
Fortune Brands 2a
FPL Group 24a
Franklin Resources 11a
Fred's 5c
Freeport-McMoRan C&G 22d
Fuller (H.B.) 22a
Furniture Brands 2a

G

Gallagher (Arthur J.) 12
Galyan's Trading 5d
GameStop 5d
Gannett 4
Gap 5d
Gart Sports 5d
Gateway 21b
GenCorp 16a
Genentech 15a

ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

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General Electric 16e
General Mills 7b
General Motors 1b
Genesco 5d
Genlyte Group 16d
Genuine Parts 5a
Genzyme General 15a
Georgia-Pacific 22e
Gerber Scientific 21d
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Global Imaging Sys. 21c
Global Payments 19b
Golden West 10b
Goldman Sachs Group 11a
Good Guys 5d
Goodrich 16a
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Grainger (W.W.) 16g
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Great A&P 6
Great Lakes Chemical 22a
Great Plains Energy 24a
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GTSI 21c
Guidant 14a
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Harrah's Entertainment 3
Harris 21a
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Hartmarx 2c
Hasbro 2b
Hawaiian Electric 24a
Hayes Lemmerz Intl. 1a
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Hershey Foods 7b
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Illinois Tool Works 16f
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IMC Global 22a
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Independence Community Bk. 10b
InFocus 21b
Ingersoll-Rand 16f
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Intuit 19c
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Kimberly-Clark 8a
Kinder Morgan 24b
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Krispy Kreme Doughnuts 3
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Lennar 2a
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Libbey 2a
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Marriott Intl. 3
Marsh & McLennan 12
Mattel 2b
Maverick Tube 9a
Maxtor 21b
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MBNA 11b
McClatchy 4
McCormick 7b
McGraw-Hill 4
McKesson 14b
MDU Resources Group 24c
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United Parcel Service
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Universal Health 14b
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BusinessWeek

Investor

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MAKING LIFE RICHER

Easy Riding

'Sport Tourers' Capture the Romance of the Road

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nvesting in
Tax Liens

SPORTS 101
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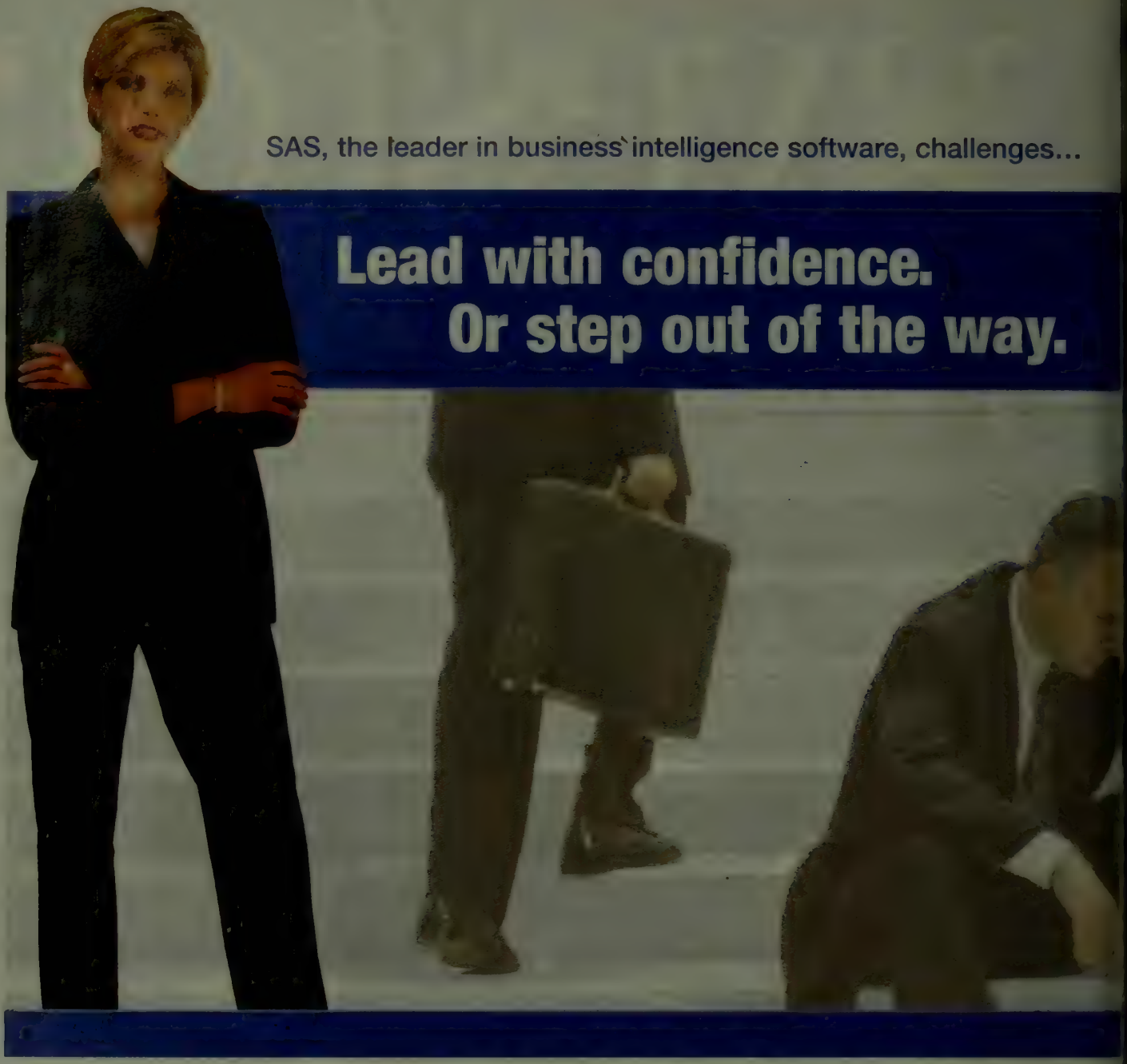
Disc Golf

BARKER 102
Profitable
Reading

SAS, the leader in business intelligence software, challenges...



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lividends

tips, tidbits & more

EDITED BY TODD I GUTNER

THE STAT

33

NT of the 2,010 lc equity funds beat ? SuperComposite ock index for the year June 30.

Data: Standard & Poor's

RD VERS

d investing may be milar than you think. erican Century ients survey of 400 found that aggressive take bigger risks with oney, while those who afe on the course handle their portfolios conservatively. Here's how golfers described their investment strategies:

INVESTING	% OF SURVEY PARTICIPANTS
shooting for birdies	35%
ng it safe with pars	63
g for distance	39
g to perfect my me	57
y much about feel ition	25
bout fundamentals bers	70
isn't everything... nly thing	47
whether you win or how you play the game	49

American Century Investments

THE INTERNET

LOG ON—AND STAY ON

America Online's latest promotion, **"1,045 hours free for 45 days,"** sounds like an awful lot of Web surfing—and it is. It works out to **23.2 hours** of free Internet access a day. To make the most of that offer, a family of four would have to split its Web time into 5.8-hour shifts. The big question: Who gets dibs on midnight to 6?

TIME OFF

A FEAST FOR THE EYES

One part pop art, two parts surrealism, and a dash of abstract expressionism: **James Rosenquist's paintings** are a puree of artistic styles. A retrospective of his work starting in the 1950s is on joint display through Aug. 17 at the **Museum of Fine Arts** in Houston and at the nearby **Menil Collection**. The exhibition goes to the Solomon R. Guggenheim Museum in New York from Oct. 2-Jan. 4, then to Spain's Guggenheim Bilbao July 17-Oct. 13, 2004.

(CLOCKWISE FROM LEFT) ILLUSTRATION BY INGO FAST. NOSE: NONE. COURTESY OF JAMES ROSENQUIST

TRAVEL

Safer Skies

PARENTS, ARE YOU TIRED of lugging your child's bulky car seat through crowded, security-clogged airports? Relief may be in sight. **A seat belt designed for children ages 1 to 4 who weigh between 20 and 45 pounds** could take flight this fall.

The belt is a simple five-point harness that attaches to a standard seat belt and "turns the airline seat into a car seat," says Larry Williams, spokesman for Phoenix-based AMSAFE Aviation, maker of the Child Aviation Restraint system.

Each airline must get approval from the Federal Aviation Administration to use the seat belts. It's up to the carriers to decide whether to offer them. So far, JetBlue is the only airline to request approval, which is expected this fall.

The seat belt may appeal to cash-strapped airlines, since it **costs only $45** and may entice more parents to buy a seat for children who are now flying for free on an adult's lap. Most important, the restraint offers better protection for the child. In the works: AMSAFE is designing a bucket-style seat belt for children less than a year old. *Stanley Holmes*

When Speed Meets Comfort

Sport tourers pack plenty of power—and amenities. BY ADAM ASTON & ROB DOYLE

THEY WERE THE HALCYON days of motorcycling. The ultracool vagabonds played by Peter Fonda and Dennis Hopper rolled along sun-baked Southwestern roads on their stretched choppers in 1969's *Easy Rider*. In 1974, Robert Pirsig's impenetrable *Zen and the Art of Motorcycle Maintenance* topped best-seller lists. Millions of Americans fell for the romance of two-wheeling. In 1973, they bought more than 1.5 million bikes, the most ever.

These days, that same generation is rekindling its romance with the road, and bike sales are growing by double digits, headed back toward their peak. Take Francesco Quinn, who has bought two bikes in recent years. For Quinn—who followed the footsteps of his famous father, Anthony, into the film industry—the open road is complemented by the intimacy it promotes with his wife on trips through southern California. "We share more in a day [of riding] than most couples share in a year," says Quinn, who owns six bikes.

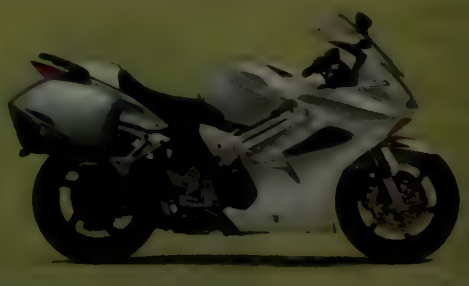
Then there's Daniel Vasella, the 49-year-old chairma CEO of Swiss drug giant Novartis, who started riding teenager. Today he takes his BMW K1200RS around th near his home in Zug, Switzerland. It's a break from th ly grind, he says, and "it gives me a chance to meet pe wouldn't ordinarily."

ROADRUNNERS

Many are finding the return to the road surprisingly fortable, thanks to a fast-growing new species of moto called the sport tourer, a category that includes Va Beemer. Sport tourers borrow heavily from built-for- fun-to-ride racing models, the so-called sportbikes. A same time, these hybrids adapt the comfortable ergon and relatively generous cargo space of traditional to bikes—such as Honda's Gold Wing and Harley-Davi Electra Glide—while stripping away much of their cu some heft. The union yields one of the most can-do bike can buy, capable of biting into the winding turns on a co road yet comfortable enough to carry two riders—and gear—on a weekend getaway.

VERSATILE BIKES
Four Top Models:
All prices include saddlebags.
*Includes antilock brakes.

BMW K1200GT
$17,990*
First-class comfort—even a heated seat



Honda Interc
$11,9
An agi
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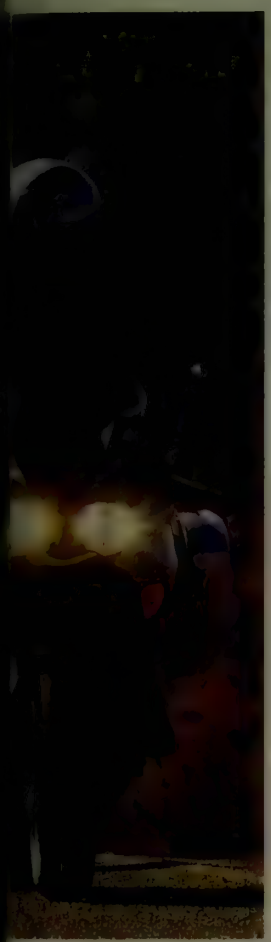


HEAVEN ON THE HIGHWAY: Honda's touring lineup (left); the FJR1300's dash (top) and the Interceptor's saddlebags

number of sport-touring models on the market has from a handful to over a dozen in recent years, with s from all of the major Japanese and European mak- st can be yours, complete with hard-sided saddlebags, ,000 to $15,000, though prices can go as high as with all the options.

ie high end, these models come packed with amenities venience and comfort as well as safety and perform- atures to make the trip more fun. Antilock brakes im- topping distance and prevent skidding. Cruise control ou a chance to relax your right hand from its usual the throttle. Electrically adjustable windshields tilt to he wind or to channel the rain.

recently took four popular models on road trips to t all the buzz is about. For comfort on a longer trip, won top spot. The Honda delivered the sharpest han- the lot. Triumph's model offers the best bang for the ut for the most exhilarating mix of speed and road s, the Yamaha edged out the rest.

German-made BMW K1200GT ($17,990) tops the category ture comforts and technical features, including unbeatably comfortable seat design, cruise control, heated handgrips and seat, as well as an adjustable windscreen—which offered welcome relief when the skies opened on our three-day jaunt across Pennsylvania farm country. BMW's four-cylinder, 1200cc engine and its shaft drive—instead of the normal chain drive—provide plenty of oomph to get up to highway speeds.

GLOBAL JAUNTS

Ride around the world with these tour operators. They offer packages that include bikes and lodging.

Beach's Motorcycle Adventures (bma.buffnet.net) A family-run business, specializing in Alpine journeys

Edelweiss Bike Travel (www.edelweissbiketravel.com) Touring on five continents; 23 years of experience

Lotus Tours (www.lotustours.com) Executive trips with 5-star hotels and a focus on adventure

SMALLER AND LIGHTER

The other European in our test group, the Sprint ST ($9,999) from Britain's Triumph, was more nimble than the Beemer. With a smaller fairing—the protective plastic shell on the front of the bike—and lower overall weight, the Sprint looks and feels more aggressive. The Sprint's zip comes from an unusual three-cylinder engine that only Triumph uses. The 955cc power plant not only delivers the snappiest acceleration of the group but also generates the deepest, most pleasing, engine note.

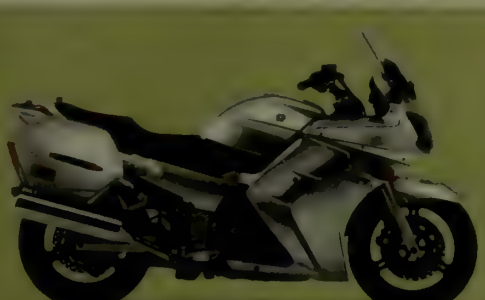
It's no surprise that Honda, the world's largest bikemaker, has staked out a big niche in the sport-touring market. We opted for the sportiest of its offerings, the Interceptor ($11,999), a bike that began life in Honda's racing workshops. Honda is famous for squeezing lots of power out of smaller engines, and the Interceptor's V-4, 781cc version is no exception. Smaller translates into lighter here, making for a more agile ride. Like Triumph's Sprint, you lean slightly forward on this bike. This offers more control, but can be less comfortable on longer trips. Last year Honda bowed to customer pressure and authorized factory-designed hard luggage for the model.

Yamaha's FJR1300 offered the best blend of comfort and performance. Originally sold only in Europe, the model garnered such outstanding reviews that U.S. enthusiasts lobbied Yamaha until the company made the bike available here ($12,599). At 1300cc, its four-cylinder engine is the most powerful of the bikes we tested. It easily matches the grunt of the Triumph but with a more stable feel, akin to the BMW's. In fact, with its electric windshield, antilock braking, and shaft drive, the Yamaha comes closest to meeting the BMW point for point, but with a hotter fire in its belly.

Their versatility explains why these bikes are winning over so many riders. Stripped of their saddlebags, any of these four would also make a fine commuter bike. Sure, the ride to work is no competition for a trek up the California coast. But these models make it easier for today's easy riders to make a quick getaway or a relaxed, meandering one.

With Kerry Capell

Triumph Sprint ST
$9,999
Strong British styling and a good value



Yamaha FJR1300
$12,599*
A fine blend of sport and touring

Easy Money It's Not

Investing in tax liens can yield returns of 5% to 15%—after a lot of legwork. BY TODDI GUTNER

EARN UP to 24% with real estate tax-lien investments—they're "virtually 100% risk-free," claims one Web promoter. Late-night television and Internet ads regularly pitch these promises.

Suspicious? You should be. Tax-lien certificates, which are legal claims for unpaid real estate taxes, are sold at auction by counties and municipalities. Much of the bidding has become so competitive that it's tough to earn the hyped rates of return. Insurance companies, banks, pension funds, and agents working on behalf of individual investors dominate the market. What's more, some owners may have skipped out on their taxes for good reason—the real estate may not be worth what's owed. Investors could end up with a building or land that is worthless or an environmental hazard.

Still, investing in tax liens ca smart way to make returns of 15%. That's if—and it's a big if— vestor understands state proper laws, knows local real estate ma and can master the often comple lien auction procedures. "It's p to get respectable returns, but cut corners on your due dili you're going to run into trouble," Joel Moskowitz, a former environ law partner at Gibson, Dunn & C er in Los Angeles and author o *16% Solution: How To Get High I Rates in a Low Interest World Tax Lien Certificates* ($26.95, An and McMeel).

BIDDING TIME

Here's how tax liens pay off f vestors: When a property owne to pay real estate taxes, the cou city places a lien on the property ernments then auction off the called tax certificates, to investo effect, the buyer is fronting the r to the government on behalf of the erty owner. In return, the buye the right to future payments o overdue taxes, plus penalties and est for a certain period of time, may run anywhere from two mon

years. If the property owner pay, the lien holder gets title to perty, even jumping ahead of the ortgage holder. After some legal bout $500, and an amount of time ries by state, the lien holder can se, evict the former owner, and property. About half of the liens d off in the first year, with some ng into foreclosure.

e than 20 states authorize tax-rtificate sales. State laws dictate le-and-foreclosure process, but ounties in certain states can still modify the rules. In general, ounties have an annual sale and one of three auction procedures. ne method, the state sets a high t rate, which is essentially the g bid. Would-be lien buyers then offering to accept a lower rate on . For example, at a recent Pinel-nty (Fla.) auction, investors bid Florida's 18% rate to an average "Some liens were bid down to says Duane Zussy, the county's tax collector.

n incentive, Florida guarantees a m 5% total return regardless of nning bid. So why doesn't the stop at 5%? By bidding the rate investors are betting that the ll be paid off in a few months y'll earn a quick 5%. For exam-sume an investor bid 3% on a lien. The 3% rate kicks in only 0 months. If the lien is paid off the state's 5% rate applies. So if is paid off in three months, the r would earn $500.

second method works like a bond he interest rate is fixed, and the r who agrees to pay the most e amount of taxes owed gets the olorado, which uses this method, rate nine points above the Fed-serve's discount rate as of Sept. year (rounded to the nearest percentage point). Currently, the ffers 10% for tax-lien certificates. hat same $10,000 lien, and sup-

cacies you'll have to master include state property tax , local real estate markets, and tax-lien auction rules procedures that can vary from county to county

n investor bought it for $10,500: a 5% premium. It would take six to recoup the premium. If the ere paid in 11 months, the in-would earn $917 in interest, but ber, the lien cost $500 over face so the net return is $417, or 4.17%. If the lien were paid in 24 months, the investor would net $1,500, a total of 15%, or 7.5% a year. Liens under $5,000 are sold at face value, says Gary Stoker, an accountant for Larimer County in Fort Collins, Colo.

Finally, some states, such as Iowa, keep the interest rate and lien price constant. Investors bid down the percentage of property the lien holder will own in the event of a foreclosure. In these auctions, institutions often bid the ownership percentage down to less than 1%. Once the ownership percentage is determined, the county uses a lottery to distribute the liens. That means investors can't choose a specific property they want—they only can hope they're offered it through the lottery. The winning lien holder becomes a partner with the property owner. So on that same $10,000 lien in Iowa, the investor earned the fixed rate per month of 2%, or $200, and 24% a year, or $2,400, for up to two years. Unless the property is a gem, it's better if the lien is paid rather than go into foreclosure.

There's also an "off the shelf" approach. That's when counties allow investors to avoid the bidding process by going to the county tax collector and buying tax liens that failed to sell at auction. In those situations, investors pay only the amount of taxes owed and automatically get the state-mandated interest rate. Arizona, which has an annual rate of 16%, is one of the states that let investors buy leftover tax liens.

HANDING IT OFF

When investing in tax-lien certificates, you can hire an agent or do it yourself. For a $25,000 minimum investment, agents buy liens on behalf of an individual investor. They travel nationwide, do local research, attend tax-lien sales, and handle foreclosures. These agents charge hefty upfront fees, as much as 20% of the amount invested. Net of fees, these promoters say they can earn 6% to 10% a year for their clients. Such agents make a killing if one of the properties for which the investor holds a lien goes into foreclosure. If the property is sold, the agent receives one-third of the sale proceeds after expenses.

Be forewarned: These tax-lien agents aren't regulated. Since many started out in financial services, you can still try a background check. Call state security regulators and ask for the Central Registration Depository record to see if an agent has had trouble with regulators. You should also ask the agent for referrals from other investors. Do not give the agent your money outright. Instead, deposit it in an escrow account at a reputable bank and have all checks written from that account to the agent and the county. Have your lawyer review all documents. You want to make sure, for example, that your money is invested individually rather than in a pool with other investors. Otherwise, make sure the pool is registered with the Securities & Exchange Commission.

Buying tax liens on your own takes much more work (table). To help with your research, Internet sites such as taxsalelists.com, taxliens.org, and taxliens.com sell books that are chock-full of state laws and CDs that are filled with lists of upcoming sales and statistics on properties. You can get this information for free, or for a nominal fee, from the county treasurer or tax assessor's office.

When buying tax liens, it's best to stay close to home. That way, you can investigate the properties you're inter-

THE LIEN MACHINE

Here are some common methods that authorities use to sell tax-lien certificates to investors:

■ **INTEREST RATE IS BID DOWN, LIEN PRICE IS FIXED** Bidding starts at the highest interest rate allowed by the state and declines from there. Whoever agrees to accept the lowest interest rate wins the lien.

■ **INTEREST RATE IS FIXED, LIEN PRICE FLUCTUATES** Starting with the amount of taxes owed, the bidding goes up from there. Highest cash offer gets the lien.

■ **INTEREST RATE AND LIEN PRICE ARE FIXED** Investors bid down the percentage of ownership they agree to accept in the event of foreclosure. The liens are then offered to investors by lottery, and they have the opportunity to accept or decline.

ested in and familiarize yourself with one state's property-tax laws. You'll want to know how the local process works, so attend a few auctions before you make your first bid. And try to find sales in rural communities, since you're less likely to be competing against institutional investors. "If you're up against the big guys, try to bid on the liens they aren't interested in, like mobile homes or small parcels of raw land," says Dana Cook, a retired bank regulator and tax-lien investor in Dallas.

Once you've determined what kind of tax lien you will buy, get the list of liens from the county tax assessor's office. Parcel numbers identify property type, and when you know that number, you can find out square footage, date built, registered owner, and tax-appraised value from county records. Be sure there are no other liens on the property. Sometimes, counties misassign parcel numbers to properties. So to make sure you're bidding on the right one, do a drive-by inspection.

Even with the most diligent research, you may still run into a dead end. David Hoshour, an investment adviser in Charlotte, N.C., has found that many "of the tax liens were no longer available by the time of the sale because the taxes were paid off."

Despite the extra effort required to buy tax liens, they're an opportunity to earn decent returns in the current low-interest environment. Just make sure your spend enough time learning the ropes before you invest your money. ■

TO-DO LIST

More than 20 states offer tax-lien certificates. But rules differ widely, even from county to county within a state. Here are a few tips to help you navigate the process:

- Invest in areas close enough to visit, where you can gain a better understanding of property values
- Seek opportunities in rural areas, where there's less competition
- Know the state property-tax laws and the local auction process
- Attend an auction a few times before bidding
- Decide what kinds of real estate tax liens you want, such as those on condos or commercial properties
- Research the properties at the county tax assessor's office

Reading Interest-Rate Tea Leaves

For insight, check the futures markets. BY SUSAN SCHERREIK

INTEREST RATES are on the rise. But how far will they go? In this installment of Market Measures, a series on analytical tools that can help sharpen your investing skills, we'll look for the answer in the financial futures market. That's where banks, corporations, and institutions often go to lock in the rates they'll pay for borrowings that they may not make for months or several years. Collectively, the prices that arise from their trading become today's market forecast of rates.

True, these forecasts don't always turn out to be prescient. But Anthony Crescenzi, bond market strategist at New York brokerage Miller Tabak, says they provide useful intelligence. "Knowing the market's expectations is the start of any investing decision," says Crescenzi, author of *The Strategic Bond Investor* (McGraw-Hill, $29.95).

To get a fix on future rates, Crescenzi suggests looking at futures contracts on Eurodollars—more specifically, dollar-denominated certificates of deposits that trade in London—because the contracts are by far the most actively traded interest-rate product.

You'll find Eurodollar futures prices in newspapers' futures tables or at the Chicago Mercantile Exchange's site, www.cme.com. Each Eurodollar futures contract represents an interest rate on a three-month deposit of $1 million. The December, 2003, contract, for instan cently traded at 98.855. Subtrac from 100, and the difference, 1. the "implied" interest rate—1.145 the December, 2004, contract, t plied rate is 2.35%. That's useful mation if you are, say, taking adjustable-rate mortgage or ho uity loan, or are wondering there'll be higher rates on CDs.

Even though the Eurodollar's est rate is pegged to the London bank Offer Rate, or LIBOR, Crescenzi says it's a proxy fo federal funds what U.S. charge one ano loans. To get proximate fed rate on contra piring in 2004 yond, Crescen tracts 0.25 of centage point from the Eurodolla

With the bond market shifting checking these futures prices fro to time will help you to keep t changing sentiments.

eurodollar futures
pit-traded prices as of 07/22/03 09:50 am

MTH/ STRIKE	OPEN	SESSION HIGH	SESSION LOW	LAST
AUG03	98.895	98.90	98.895	98.897
SEP03	98.91	98.915	98.905	98.
OCT03	98.88	98.885B	98.88	98.8
NOV03	----	----	----	--
DEC03	98.845	98.86	98.835	98
JAN04	----	----	98.80A	9
MAR04	98.68	98.705	98.66	98
JUN04	98.41	98.435	98.375	9
SEP04	98.04	98.08	98.01	9
DEC04	97.615	97.66	97.58	--

EURODOLLAR CONTRACTS: They're a good indicator because they're actively traded

GOING FOR PAR: Players throw discs of different sizes to make "shots"

ook, Ma. lo Clubs

golf is catching on. It's fun, fast, and free.

ITH ARNER

HRIS MAHON SWEATS his way toward the 13th hole of the golf course outside Worcester, Mass. "It's going to be tough," says Mahon, a 29-year-old trader for Fidelity Investments, as he scans the narrow fairway dotted with trees. He frowns, then reaches into his bag for his driver—a bright red plastic disc.

What happened to the 1 wood? The game is playing is actually disc golf, where colorful plastic milar to Frisbees replace clubs and balls, bushel-size strung up on poles replace the small hole in the and some of the mostly male players sport ponytails -dyed T-shirts instead of collars and wing tips. And golf, admission to the 1,135 public and private disc-golf —twice the number in 1997—across the U.S. is usu- e. (Private courses are often on some player's land.) are no tee times, no greens fees," says Mike Snelson, r of Gotta Go Gotta Throw, a wholesaler of disc golf Minneapolis. "I can play nine holes and be back to 45 minutes."

's how the game works: Like traditional golf, disc typically have 9 or 18 holes. The holes run from 00 feet to 500 feet and range from par 3s to par 5s, with par 3s being more typical. Scoring is the same, with birdies, pars, bogies, and worse. Players throw the disc, pick it up where it lands, and throw again—usually using a different disc—until they "putt" with a smaller disc into the basket. A good player can "drive" about 300 feet, beginners 200. Pros carry about a dozen discs of different sizes and rim depths for different throws. Some are designed for long, slow curves to the right or left, others for rapid curves.

Disc golf is more free-spirited than the traditional game, but it's not just for slackers and Jerry Garcia fans, either. Steve Hartwell, an IBM software programmer from Reading, Mass., plays regularly and has made it a family affair: He, his wife, and two kids often play and compete in tournaments. The buzz on the circuit is that Supreme Court Justice Sandra Day O'Connor plays and even bought gear for a resort she frequents in Wisconsin. Discraft, of Wixom, Mich., and Innova Disc Golf of Rancho Cucamonga, Calif., are the leading disc makers. Prices range from $6.99 to about $11.99.

The game's been around since the mid-1970s, but now is spreading out from its strongholds in the Midwest, Texas, and California. Between 5 million and 10 million people have played disc golf at least once, and about 500,000 play regularly, says the Professional Disc Golf Assn., the nonprofit governing body for the sport. The PDGA writes the rules, serves as an information clearinghouse for the sport, and sponsors tournaments. Total purses in 2002: more than $1 million. Course and tournament info can be found at pdga.com.

At a recent tournament near Worcester, Mahon explains his strategy as he steps up the tee for the 361-foot, par-4 hole: "I'm just trying to pitch around the trees on the way down, nice and tight." The "fairway" is a path through the woods.

A hush falls over the other members of his fivesome as Mahon winds up. The disc flies straight and low for more than 150 feet, avoiding all trees. "Sweet!" says one admiring golfer. Mahon parred the hole with his orange putter. Another player who gambled on his putt and ended up over a cliff finished the hole in eight strokes. Like golf, it can make you tear your hair out. ■

DISC LINKS

For course info, equipment sales, tournament schedules, and disc golf gossip, try:

discgolf.com
disclife.com
nefa.com
pdga.com

SUMMER READING WORTH INVESTING IN?

BY ROBERT BARKER rb@businessw

IF ONLY WE COULD READ our way to wealth. Then, by my calculations, I would've turned the pages of enough become-a-better-investor books to split my time between homes in Paris and Fiji, endow three university chairs, and lease a luxury suite at Dodger Stadium. Alas, no. Just the same, some of these books are valuable. In fact, one of the best-ever investing guides is back this summer in an impressive revision.

The Intelligent Investor, first published in 1949 by the Moses of value investing, Benjamin Graham, went through five versions before his death in 1976. While still an invaluable exposition of such basics as the centrality of buying securities at prices low enough to ensure a "margin of safety"—a cushion to absorb mistakes—the final, 1972 revision suffers by relying on case studies that are too remote to resonate now. Happily, this vastly expanded new edition is full of fresh examples and commentaries applying Graham's principles to today's markets. This is the considerable work of financial journalist Jason Zweig of *Money* magazine.

At 623 pages, this duet is nearly twice as long as Graham's solo, with Zweig chiming in after each of Graham's original 20 chapters. For example, where Graham analyzes Penn Central, Ling-Temco-Vought, NVF, and AAA Enterprises, Zweig follows with sharp dissections of Lucent Technologies, Tyco International, AOL Time Warner, and eToys. You won't confuse the two authors' prose. "If a broker ever tries to sell you an individual mortgage bond or 'CMO' tell him you are late for an appointment with your proctologist," Zweig writes. Were Graham alive, he surely would have edited that out. But I'm quibbling. Zweig took on a daunting task and succeeded admirably. "Enterprising investors," as Graham calls the few willing to put in the time and pencil work to uncover value in stocks, will find this book well rewarding.

Wealth of Words

The Intelligent Investor, Revised Edition
Benjamin Graham, with Jason Zweig, HarperBusiness Essentials (623 pp, $19.95)

A Random Walk Guide to Investing: Ten Rules for Financial Success
Burton G. Malkiel, W. W. Norton (224 pp, $22.95)

The Equity Culture
B. Mark Smith, Farrar, Straus & Giroux (344 pp, $25)

Most investors, Graham knew, aren't so diligent. They will be better served by an iteration of another classic due in September. Burton Malkiel, the Princeton University economist whose *A Random Walk Down Wall Street* has for 30 years been the leading exponent of efficient markets—the theory that

active stock picking is pointless—has distilled his big ide *The Random Walk Guide to Investing: Ten Rules for cial Success.* You've heard most of these before: Fire y vestment adviser. Split assets among stocks, bonds, ca real estate. Weigh risks even as you imagine returns time markets. Diversify. Keep costs low. If familiar, this is laid out by Malkiel in a neat way, far from the Ivory

A veteran trustee of Vanguard Group, Malkiel pred directs readers to index funds, but also suggests most can safely avoid mucking up their portfolios with inter al funds. Global markets today, he reasons, are closely and many U.S. companies have large exposures to economies. Maybe most of all, to Malkiel the key to b wealth is to get on the right track—yesterday. "Procr tion," he writes, "is the natural assassin of opportunity

Hungry for something wholly new, I opened B. Smith's *The Equity Culture.* Although this term p more and more—a search of the Nexis database foun mentions in 1990 and 352 in 2000—I've never been sur it means, exactly. To Smith, an ex-Wall Street trader a thor of 2001's *Toward Rational Exuberance: The Evolu the Modern Stock Market,* equity culture is the per global focus on, and investment in, stocks. He goes tracing its rise from the ancient Romans to China's c capitalists. Yes, the right word here is "sweeping." touch for history can be engaging, notably his depiction jamin Disraeli's early stock market defeat and how Markowitz. came on modern portfolio theory. Yet I ofte myself searching vainly for a thread of argument to tie it Graham or Malkiel are surer bets toward a ticket to Fi

AMERICA
Is, United States
iner's daughter and native West
, Bonds has won the Goldman
ental Prize for leading campaigns
ountaintop removal coal mining.
ly destructive "strip mining on
s ravaging communities throughout
a, turning river valleys into mining
nps, driving up asthma rates and
milies to abandon their homes.
uck Wyrostok

ojo-Agudo, Spain
st and economics professor, Arrojo
he Goldman Environmental Prize
mpaign to stop Spain's National
gical Plan from damming and
the country's last free-flowing rivers.
arheading a new wave of activism
ng a sustainable water future based
rvation, recycling and informed
al choices. *Photo by Fernando Maselli*

AND SOUTH AMERICA
na Foronda Farro, Peru
has won the Goldman
ental Prize for her campaign to
Peru's fishmeal industry, which
ntreated industrial waste into
nd out of smokestacks. She has
partnerships between community
shmeal producers and the govern-
institute environmentally sound
table business practices.
David Mertz

Those who exploit the environment count on people doing nothing.

Thanks for proving them wrong.

ASIA
Von Hernandez, Philippines
Hernandez has won the Goldman Environmental Prize for organizing campaigns against waste incinerators in the Philippines, which release cancer-causing dioxins into the air. He led the Philippines to institute the world's first nationwide ban on waste incinerators. Despite intense industry pressure and government corruption, he persists in his work to keep the ban in place.

ISLANDS AND ISLAND NATIONS
Eileen Kampakuta Brown & Eileen Wani Wingfield, Australia
Brown and Wingfield have won the Goldman Environmental Prize for their leadership in the campaign to block construction of a nuclear waste dump in their homeland. In the 1950s, British nuclear bomb tests in Aboriginal lands caused birth defects, cancer and the poisoning of the environment and wildlife. Now, Brown and Wingfield say *Irati wanti — the poison, leave it.*

AFRICA
Odigha Odigha, Nigeria
Odigha has won the Goldman Environmental Prize for securing unprecedented protections for Nigeria's remaining rainforests. He was instrumental in creating a statewide logging moratorium and has educated hundreds of forest communities on sustainable forestry practices. His work has resulted in representation for civil society in all forest management policies.

Goldman Environmental Prize is the world's largest prize for grassroots environmentalists. Awarded
lly since 1990, the Prize has been presented to 94 people from 57 countries. Each of the winners,
n from the planet's six inhabited continental regions, receives $125,000. These individuals demonstrate
ional courage and commitment, often working at great risk to protect our environment and, ultimately,
Earth. In the process, they inspire the rest of us to do the same. Richard N. Goldman

The Goldman Environmental Prize

The world's largest prize for grassroots environmentalists.

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AMAZON.COM IS MAKING MONEY—AND THE STOCK IS CLICKING

TOP SUMMER PICKS: ALBERTO-CULVER, COMPASS, AND OXFOR

WHY THE SHIPPING NEWS IS EXCELLENT AT GENERAL MARITIM

BY GENE G. MARCIAL

Brawny at Amazon

Once again, Amazon.com (AMZN) is roiling the Street: Critics of this online book, music, and video giant are quick to pan the stock as overpriced—at 47 times 2004 forecast earnings of 85¢ a share. Bulls, however, reckon that with Amazon finally making money, the jump to 40 from 12 a year ago is justified—with more to come. So says Bill Harnisch of Forstmann-Leff-Peconic Partners, featured here on Oct. 14, 2002, when the stock was at 17. He had snapped up Amazon as it crashed to 8 on Sept. 17, 2001 (the stock was at 113 in 1999). He bought more this year at 37, after Amazon posted strong second-quarter results and raised its forecasts. Says Harnisch: "I get more enthusiastic as I look at the numbers." Profits are up—on surging sales and low operating-expense growth. And Amazon has huge free cash flow, which Harnisch puts at $430 million, or $1.03 a share, by yearend 2003; at $642 million, or $1.13, in 2004; and $642 million, or $1.54, in 2005. With Amazon's estimated yearly profit growth of 40%, Harnisch sees the stock at 60 in a year. But if Amazon pays off its costly $2 billion debt, as he expects, earnings will get a boost and kick the price to 65. Mary Meeker of Morgan Stanley, who rates Amazon "overweight," has raised her estimates: to 54¢ a share in 2003 on sales of $5.04 billion, to 84¢ in 2004 on $5.9 billion, and $1.21 in 2005 on $6.8 billion. Unit sales are up sharply, reinforcing Amazon's strategy, says Meeker, who owns shares. Her bullish calls on Amazon in the 1990s stirred controversy. Morgan Stanley aims to do banking for Amazon.

Poised to Survive Third-Quarter Doldrums

Don't be surprised if the market stalls right around here: History shows that the Standard & Poor's 500-stock index tends to stumble in the third quarter, says Sam Stovall, S&P's chief investment strategist. Since 1945, the index has had its weakest gains in the third quarter. Over the years, the index has risen 2.4% in the first quarter, 2.1% in the second, 0.1% in the third, and 4.1% in the fourth. Summer profit-taking takes a toll, says Stovall. So get defensive, says Stovall: Stocks with steady growth and low risk profiles (low betas) fare best in this period. Stovall's top picks: Hair-care and beauty-aid gi
berto-Culver (ACV); regional lender Compass Bancshares
and Oxford Health Plans (OHP). Alberto-Culver, aided
quisitions, is ranked A+ by S&P in earnings and dividend quality. At Compass, with 117 branches in the Sunbelt, loans and deposits are growing faster than the industry average. It has a 3.1% payout yield and is also ranked A+. Oxford, which manages hea
plans, trades at a discount to its peers. With revenues e
to rise 11%, to $5.4 billion, in 2003, Oxford should shine
says Stovall. S&P's investment-policy panel forecasts the
will close 2003 at 1030—up 17% for the year.

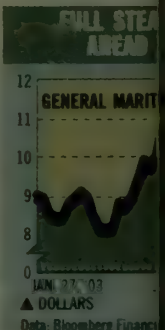
STOVALL'S CHOICES

STOCK	PRICE 7-30-03	EARNINGS PER SH 2002	2003*
ALBERTO	55.93	$2.32	$2.67
COMPASS	34.20	$2.43	$2.64
OXFORD	45.10	$2.45	$4.25

*estimated Data: Standard & Poor's, *Busi*

General Maritime: Its Tanker Business Is Brisk

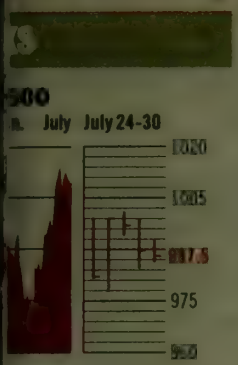
Some value investors are betting on General M
(GMR). With a January purchase of 19 ship
Athens' Metrostar Management, it is No. 2
size tankers. Its 46 vessels ply the Atlantic B
cluding the North Sea and Black Sea. Maritir
a "strong position" to capitalize on the dwindling tanker
and a rise in U.S. oil imports as the economy perks u
Gary Goldstein of Gilford Securities. Its stock has surge
5 in October to 11.60 on July 30. But, he adds, it's still trading at only 3.8 times his 2004 earnings estimate of $3 per share—and below book value of $14 a share. Goldstein's 18-month target: 19. Maritime posted record earnings in the first half. "We expect the full impact of the acquisitions in the third quarter," says CEO Peter Georgiopoulos. He figures they would add 30% to 35% to earnings on a full-year basis. Magnus Fhyr of Jefferies raised his 2003 earnings estimate to $2.61 a share, and for 2004 to $2.90 (reflect
19 tankers' contribution), up from 9¢ in 2002. He rates th
a buy. Jefferies co-managed Maritime's IPO in 2001.



BusinessWeek online Gene Marcial's Inside Wall Street is
at businessweek.com/today.htm at 5
the magazine's publication day, usually Thursdays. See Gene on Frid
1:40 p.m. EST on CNNfn's *The Money Gang*.

Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships

FIGURES OF THE WEEK

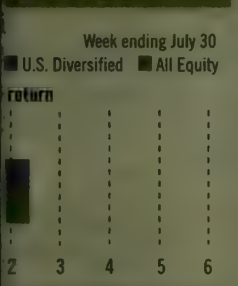


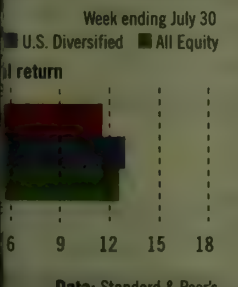
RY

arket turned in a tepid this week. The NASDAQ dex and the Dow Jones rage squeaked by with each. The S&P 500 a 0.1% loss. Weighing arket: less than stellar r earnings, rising Treand a surprising drop in er confidence.

Financial Markets, Reuters

AL FUNDS





Data: Standard & Poor's

U.S. MARKETS	JULY 30	% CHANGE WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	987.5	–0.1	12.2	9.4
Dow Jones Industrials	9200.1	0.1	10.3	6.0
NASDAQ Composite	1720.9	0.1	28.9	28.0
S&P MidCap 400	496.2	0.7	15.5	12.2
S&P SmallCap 600	231.6	1.4	17.8	14.2
Wilshire 5000	9526.6	0.1	14.2	11.3
SECTORS				
BusinessWeek 50*	579.0	–0.7	6.7	5.5
BW Info Tech 100**	310.3	0.1	8.7	10.7
S&P/BARRA Growth	500.2	–0.4	11.5	7.9
S&P/BARRA Value	483.8	0.2	13.0	11.0
S&P Energy	188.5	–1.4	2.9	1.4
S&P Financials	344.4	0.3	16.0	12.9
S&P REIT	105.2	3.0	15.8	8.6
S&P Transportation	176.4	–1.0	3.8	1.1
S&P Utilities	104.6	–1.2	7.0	0.6
GSTI Internet	129.9	–2.8	73.9	95.0
PSE Technology	586.9	–0.1	28.0	26.9

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JULY 30	% CHANGE WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	959.8	1.1	13.7	8.6
London (FT-SE 100)	4141.2	1.3	5.1	–1.0
Paris (CAC 40)	3172.5	2.7	3.5	–6.1
Frankfurt (DAX)	3429.0	3.8	18.5	–11.6
Tokyo (NIKKEI 225)	9632.7	0.2	12.3	–2.5
Hong Kong (Hang Seng)	10,121.2	2.2	8.6	–1.4
Toronto (S&P/TSX Composite)	7205.0	–0.4	8.9	10.7
Mexico City (IPC)	7260.2	–0.3	18.5	20.7

FUNDAMENTALS	JULY 29	WK. AGO	YR. AGO
S&P 500 Dividend Yield	1.65%	1.65%	1.71%
S&P 500 P/E Ratio (Trailing 12 mos.)	29.1	31.1	32.0
S&P 500 P/E Ratio (Next 12 mos.)*	17.0	17.0	16.1
First Call Earnings Surprise*	6.51%	6.01%	1.46%

*First Call Corp.

TECHNICAL INDICATORS	JULY 29	WK. AGO	READING
S&P 500 200-day average	908.7	903.7	Positive
Stocks above 200-day average	79.0%	80.0%	Negative
Options: Put/call ratio	0.71	0.71	Positive
Insiders: Vickers NYSE Sell/buy ratio	4.15	4.12	Negative

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Motorcycles	16.1	Internet Software	130.6
Constr. & Farm Machinery	15.0	Wireless Services	97.6
Semiconductor Equip.	14.1	Internet Retail	85.5
Employment Services	14.0	Office Electronics	54.4
Health-Care Facilities	13.7	Biotechnology	50.7

WORST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Multi-Utilities	–15.1	Tires & Rubber	–51.0
Tobacco	–11.4	Health-Care Facilities	–40.6
Oil & Gas Drilling	–9.7	Food Chains	–24.0
Airlines	–7.6	Automobiles	–19.5
Oil & Gas Exploration	–7.1	IT Consulting	–15.8

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Pacific/Asia ex-Japan	8.2	Precious Metals	37.8
Diversified Pacific/Asia	5.7	Communications	33.6
Small-cap Growth	5.4	Latin America	31.3
Japan	5.2	Technology	26.8
LAGGARDS		**LAGGARDS**	
Utilities	–4.0	Japan	–3.2
Natural Resources	–3.2	Diversified Pacific/Asia	3.3
Domestic Hybrid	0.0	Foreign	6.6
Communications	0.6	Miscellaneous	7.1

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
American Heritage	28.6	Jacob Internet	132.2
PFds. Smicdr. Usctr. Inv.	17.4	Apex Mid Cap Growth	106.1
Henlopen	16.5	Amerindo Technology D	105.6
Matthews Asian Tech.	14.5	Fidelity Adv. Lvgd. Co. A	96.5
LAGGARDS		**LAGGARDS**	
PFds. UltSh. OTC Inv.	–10.1	Rydex Dynam. Vent. 100	–59.1
Rydex Dynam. Vent. 100	–10.0	PFds. UltSh. OTC Inv.	–59.0
Fidelity Sel. Egy. Serv.	–9.5	Potomac OTC/Short Inv.	–33.6
Rydex Energy Svcs. Inv.	–8.9	Rydex Arktos Investor	–31.5

INTEREST RATES

KEY RATES

	JULY 30	WEEK AGO	YEAR AGO
MONEY MARKET FUNDS	0.64%	0.65%	1.41%
90-DAY TREASURY BILLS	0.95	0.91	1.69
2-YEAR TREASURY NOTES	1.62	1.49	2.24
10-YEAR TREASURY NOTES	4.31	4.11	4.46
30-YEAR TREASURY BONDS	5.25	5.04	5.30
30-YEAR FIXED MORTGAGE†	6.23	5.05	6.44

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
GENERAL OBLIGATIONS	3.97%	4.82%
TAXABLE EQUIVALENT	5.67	6.89
INSURED REVENUE BONDS	4.01	4.99
TAXABLE EQUIVALENT	5.73	7.13

EEK AHEAD

INVENTORIES *Monday, Aug. 4, 10* ▶ Manufacturing inventories are to be unchanged in June, follow- consecutive declines of 0.1%. ccording to the median forecast of sts surveyed by MMS International.

FACTURERS' INDEX *Tuesday, Aug. 5, EDT* ▶ The Institute for Supply nent's nonmanufacturing-activity st likely held steady in July, after x surged to 60.6% in June. Also ging in June was a rise in employ- the first time in five months.

PRODUCTIVITY & COSTS *Thursday, Aug. 7, 8:30 a.m. EDT* ▶ Output per hour worked in the second quarter probably increased at a 2.1% annual rate, following a 1.9% rise in the first quarter. Unit labor costs are expected to have grown by 1.5% for a second straight quarter. Strong productivity gains are helping businesses increase output and profits. However, the push for greater efficiency is hampering a recovery in the labor market.

INSTALLMENT CREDIT *Thursday, Aug. 7, 3 p.m. EDT* ▶ Consumers probably added $6 billion of new debt in June, following a $7.3 billion increase in May. Incentive-laden vehicle deals are the driving force behind the recent borrowing rise.

The *BusinessWeek* production index climbed to 200.2 in the week ended July 19, up 3.5% from a year ago. Before calculation of the four-week moving average, the index rose to 201.1.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit **www.businessweek.com/magazine/extra.htm**

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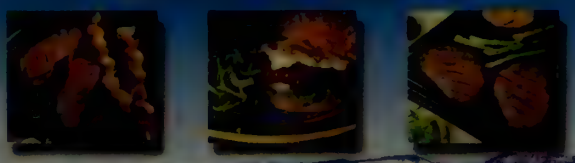

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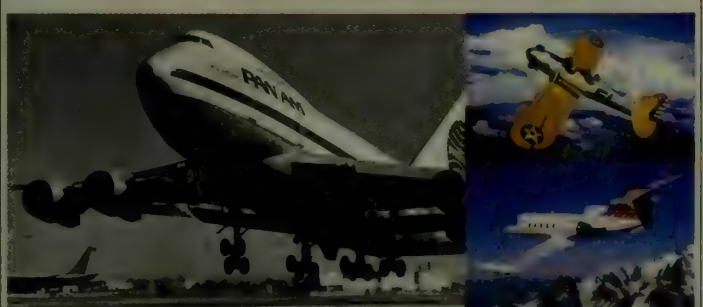

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OVERCOMING NASDAQ'S CRISIS

Nothing symbolized the high-tech boom of the '90s more than NASDAQ, the stock market for startups and investors willing to bet on them. The crash of tech stocks is an oft-told tale, but it comes as a surprise that NASDAQ itself is in steep decline, with its future much in doubt (page 64). The timing could not be worse. Technology stocks are rebounding, the high-tech sector of the economy is turning around, and the initial public offering market will soon be heating up again as entrepreneurs seek capital to start new companies. Will NASDAQ be able to play its pivotal role once again? If not, can the New York Stock Exchange, regional exchanges, or the new electronic communications networks (ECNs) fill the void? Probably, in time, but time is of the essence. NASDAQ has put a proposal before the Securities & Exchange Commission to help its revival. It's a sensible proposition that deserves the commission's quick action. Adhering to a doctrinaire position may not be in investors' best interests.

NASDAQ's troubles stem from a '90s price-fixing scandal. In response, the SEC encouraged the growth of competing order-driven ECNs, which have since gone on to eat NASDAQ's lunch. To regain competitiveness, NASDAQ now wants to become a full-fledged stock exchange, like the NYSE, which would allow it to raise capital and perhaps buy an ECN.

The SEC is balking. All other U.S. stock exchanges "price-time priority" rules that allow customers who of best price for a stock to have their orders filled f wants NASDAQ to do the same. But at NASDAQ, dealers Charles Schwab & Co. and Knight Securities match and sellers on their own books without allowing any participants to interact. If these market-makers are into "price-time priority," they will simply flee to an EC DAQ is caught between its dealers and the SEC.

The SEC should show some flexibility on its 70-y statute on price-time priority. The commission took a that direction under former Chairman Arthur Lev who ordered all stock exchanges and ECNs to post dat the execution of trades on the Web. This ruling was in to show investors which market centers were doing t job. NASDAQ argues that it has the data to prove t vestors get high-quality execution, even though it follow "price-time priority" rules. The key issue bef SEC should be the desire to ensure that investors get t possible trades regardless of the formal rules governi trading institution. NASDAQ promoted entrepreneu back in the '90s. It deserves another chance to pl key role today.

RETHINKING THE DRUG BUSINESS

Big Pharma needs a new business model. The pharmaceutical industry generates big profits that pay for developing drugs by segmenting its global markets and charging U.S. consumers more than anyone else. Washington plays a key role by imposing trade barriers that prohibit the reimporting of cheaper drugs sold by drug companies outside the country. The model works as long as Americans are willing to bear the financial burden. Increasingly, they are not. The recent bipartisan vote in the House (87 Republicans, 156 Democrats) for a bill to permit reimporting cheaper Canadian drugs reflects a political groundswell to curb the cost of drugs in the U.S. (page 26). The industry would do well to start crafting a business model that doesn't depend on trade protectionism and artificially high U.S. drug prices.

The truth is that today, most drug prices are determined not by markets but by clout. The weak pay the most. Overseas, big state public-health systems bargain with U.S. drugmakers to get the lowest possible prices. Behind the bargaining is the implied threat, especially from Third World countries, that they will break the patent and produce the drugs themselves if the price isn't right. Mexico is threatening to produce cheap copies of patented drugs (page 28). In the U.S., HMOs, corporations, and even states such as Vermont negotiate drug prices as well. Yet even they have not been able to stop the cost of drugs from rising.

Those who pay the highest prices for drugs in Amer elderly citizens not covered by ex-employers, HMOs surance. They constitute the approximately 15% of th market that pays cash for drugs. This group is now i revolt. People in virtually every retirement community nation are importing cheaper drugs from Canada, through the Internet or through hundreds of storefr Florida and elsewhere. Today, 1% to 2% of the nation billion drug bill is spent on imported drugs. It is growi

Political support and public tolerance for Big Ph model is eroding. Despite millions spent for campaig tributions and on lobbying, Congress is rightly begin view the barrier to reimportation as protectionism. middle-class Americans, especially the elderly, it mak and less sense to subsidize middle-class Canadians a ropeans. The solution: bring every American, especia elderly, into a private or public health-care organizati can bargain for lower drug prices with the drug indu

The erosion of U.S. trade barriers to reimportation timately mean that drugmakers will be unable to s their pricing. The best-case scenario for the industry i single global market emerges and prices in the U.S lower while prices offshore rise. More likely is that U.S fall to Canadian levels. Big Pharma should start thinkin where it is going to get the profits it needs for the fut

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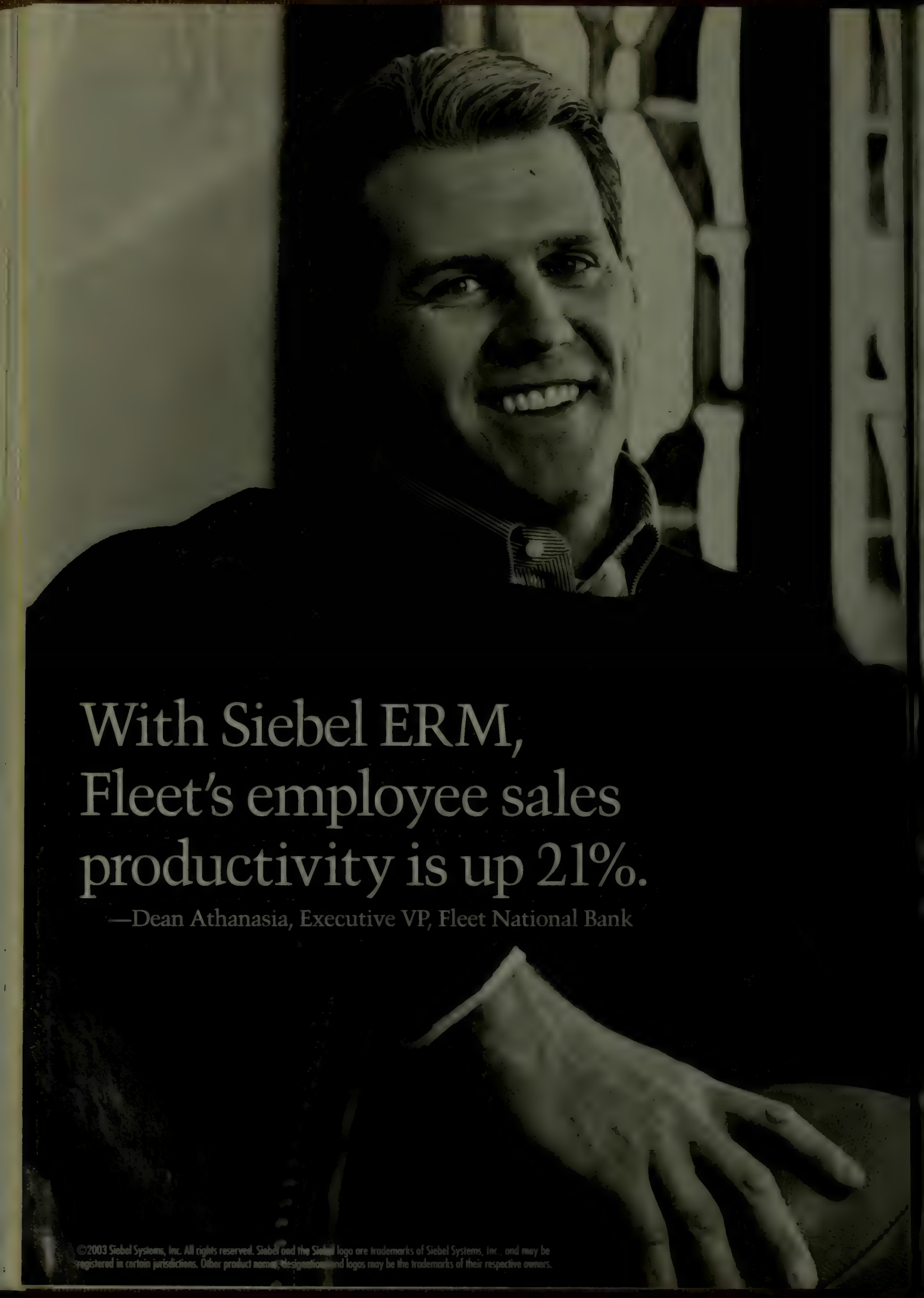

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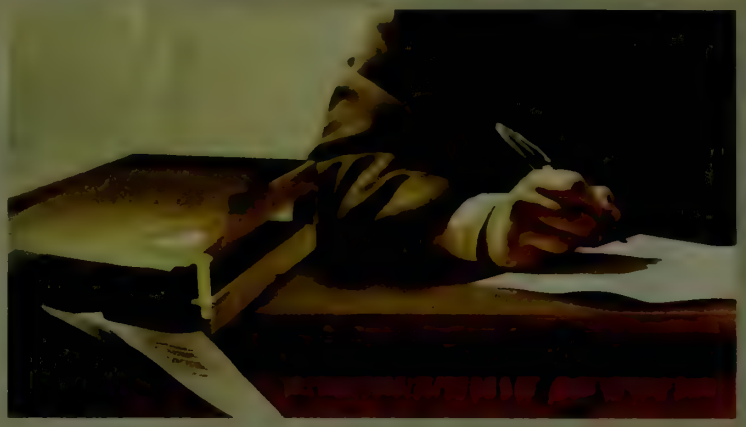
OUTSOURCING JOBS: IS IT BAD?

Two of our economists debate the pros and cons of companies moving U. S. jobs to India, China, and other low-wage countries page 36



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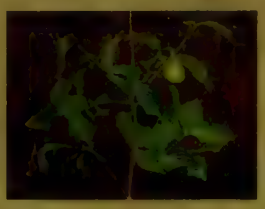
THE FUTURE OF TECHNOLOGY



g Picture

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, parts of the industry have ered. But that's how the nology industry works, and fruit is on the way

GIFT THAT KEEPS ON GIVING
1990s boom in tech spending fuels productivity growth in y parts of the economy

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Looking Good for '04

Yes, even with the economy and employment as slow as they have been, two proven political prognosticators see omens pointing strongly to a Bush victory—maybe even a landslide

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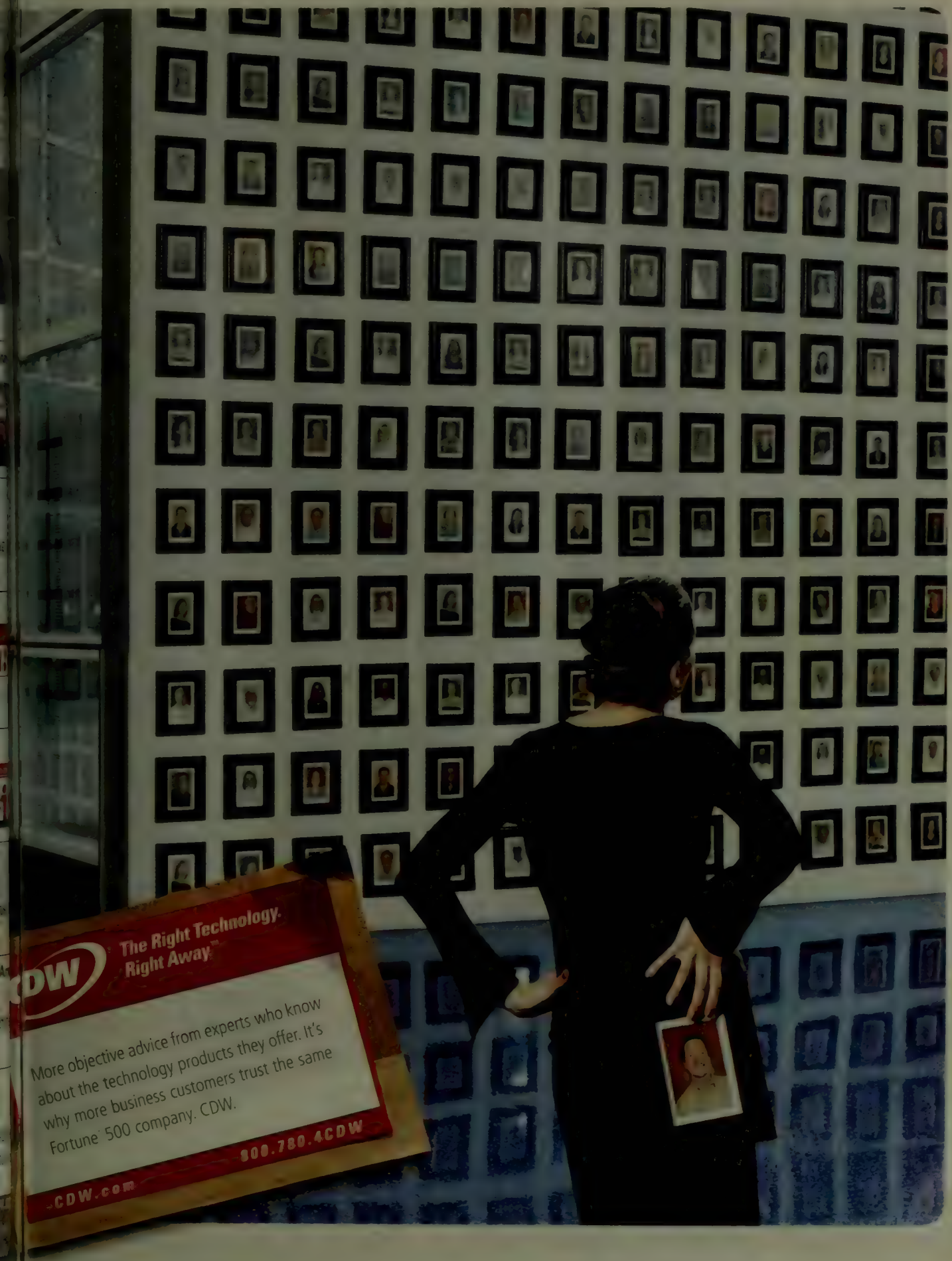

Up Front

EDITED BY IRA SAGER

TALK SHOW "Microsoft is a big intellectual roach mote All the big minds go in, and they don't come out."

—Paul Saffo, director of the Institute for the Future, on innovation (page 112)

CORPORATE CULTURE

NEW PLANKS IN MERRILL'S BOARD?

MERRILL LYNCH CHAIRMAN and CEO Stan O'Neal has certainly made his mark on the executive suites of the world's largest brokerage. On Aug. 6, head of investment banking Arshad Zakaria became the 10th senior exec to exit since O'Neal became president in 2001. According to Merrill, Zakaria, 41, will "retire" at the end of the year. The announcement comes one week after his mentor, Vice-Chairman Thomas Patrick, was forced out.

Now watch for O'Neal, 51, to put his stamp on the board. In the next three years, 5 of Merrill's 11 directors will reach the mandatory retirement age of 72. For example, W. H. Clark, former chairman of Nalco Chemical, is 71. Former Pitney Bowes Chairman George Harvey is 72. And board member Robert Luciano, the former chairman of Schering-Plough, turns 70 in October. "The ability of a CEO to appoint his own candidates to the board is almost as valuable as the President appointing a Supreme Court justice," says Michael Madden, a general partner of private equity firm Questor.

Part of the reason for the bad blood between O'Neal and Patrick revolved around Patrick's frustration at not getting a board seat. In June, O'Neal backed Alberto Cribiore, 57, managing partner of private equity firm Brera Capital, for the board. Patrick could not be reached for comment. *Emily Thornton*

RETIREMENT REPORT

THE GREENING OF PENSION PLANS

CASH-STRAPPED U.S. STEEL may have hit on a solution for companies scrounging for the dough to pump up pension funds that were recently flattened by the stock market's slide. Just sign over some forests—or other valuable assets.

On Aug. 4, the steelmaker told analysts it was asking for government permission to transfer 170,000 acres of timberland, mostly in Alabama, to its pension funds. The company values the assets at $100 million. But the trees are young so the "valuation will grow over time," says Chairman Thomas Usher. He hopes to get Labor Dept. appr by yearend.

Although not as creati few other companies been thinking outside the too. General Motors m $1.24 billion in Hughes tronics stock into its un funded pension plans ea this year. Truck maker N tar Internati got the O. put $175 lion of shares in funds. Northw Airlines waiting approval contribute s in a commu airline subsid The request been hung up cause the stock, not pub traded, is hard to value. S ly there must be other tr ures in the corporate that companies could over. *Michael A*

VACATION NATION

FRANCE: CALLING ALL UGLY AMERICANS

STILL NURSING A GRUDGE against France? No need to pour your Bordeaux down the drain. This summer, the French are getting hit where it really hurts: their $110 billion-a-year tourist industry. Visits by foreigners were down an estimated 25% in July from the year before—bad news when tourism accounts for 6.6% of the economy. "The summer has been a total bust," says André Daguin, head of a leading hoteliers' group.

LONELY: *The Eiffel*

Hotels and tour operators say bookings by Americans are off 50%, but not because of boycotts. The big culprit is the euro, which has gained 15% in value against the lar and 11% against British pound in the year. That hurts beca France gets more Amer and British tourists than other European country.

Adding to the glo strikes by performers fo the cancellation of sum arts festivals Avignon and o cities. And in J vacation s along the Medi ranean were e uated because wildfires. E Mickey Mouse hurting. Euro ney shares 23% on Aug. 1 ter the company said it m not meet debt repayments cause of a falloff in visito

Not everyone is stay home. France will likely 70 million visitors this y more than its populatio 60 million. *Carol Matl*

THE LIST **FAT PROFITS**

The recent focus on obesity has led some companies to improve the nutritional content of the food they sell. It also has made those who sell high-fat food more vulnerable to lawsuits. Below, the share of operating profit derived from the sale of such food by:

COMPANY	OPERATING PROFIT FROM FATTY FOODS (PERCENT)
HERSHEY FOODS	99%
McDONALD'S	99
CADBURY	90
PEPSICO	77
COCA-COLA	72
HEINZ	50
NESTLE	46
KRAFT FOODS	35

Data: UBS Warburg

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Up Front

THE DEAL MILL

A RUSH TO BAIL OUT OF FINANCE

IN THE 1990s, COMPANIES rushed to boost revenues by building up their own finance businesses. Today, many are racing to get rid of them. On July 15, Sears Roebuck sold its credit-card operations to Citigroup for $3 billion. Now, Circuit City Stores says it's considering unloading its $3 billion portfolio of bank and credit-card receivables.

The scale of the deal flurry is impressive. Companies from energy provider Aquila to communications-services provider Alltel have sold $7 billion worth of financing businesses this year. That's the most since 1998, when such sales peaked at $8.4 billion, according to Thomson Financial. By yearend, the total could reach $10 billion. "This is one of the few areas of mergers and acquisitions that has grown," says Richard Peterson, a strategist at Thomson.

Retailers' credit-card portfolios are the hot targets. Buyers are eyeing Kohl's and Target. But they say they're not interested in selling.

Why have other retailers sold? They get deadbeats off their books and eliminate a potential drag on their valuations. Sears shares rose 14%, to $40, in the five trading days after it announced the sale of its card portfolio. That alone may not be enough to inspire deals, but it certainly can't hurt. *Emily Thornton*

SNAIL MAIL

YOU OUGHTA BE IN...STAMPS?

WANT YOUR 15 MINUTES OF fame but can't get on *Survivor*? Would you settle for a postage stamp?

On July 23, as part of an effort to help the U.S. Postal Service tackle its $92 billion in debt, liabilities, and obligations, the President's Commission on the U.S. Postal Service recommended that the Service sell personalized stamps.

With e-mail eating into mail volumes, the stamps could make snail mail more attractive. The Commission envisions parents mailing cards with photos of their newborns on the stamps. "Allowing mailers to personalize stamps would add value to sending materials by mail," says Harry Pearce, co-chairman of the Commission.

Canada got this ball rolling in 2001. Canadians can send a picture to their post office, which turns it into a stamp. Celebrity photos, or pictures the sender doesn't own, aren't allowed. Aside from that, a dollar—52¢ more than a first-class stamp in Canada—lets you put pretty much whatever you want on your mail. So maybe junior's first word could be "cheese," eh? *Alicia Henry*

DRAWN & QUARTERED

TAXING MATTERS

JOCKS GET SOCKED, CEOs GET A PASS

THERE'S NO DOUBT IT WOULD be fun to be Tim Duncan for a day—as long as it's not tax day. Duncan, who earned $12 million last season while leading the San Antonio Spurs to an NBA championship, will pay an estimated $288,000 in "jock tax," a form of nonresident income tax athletes pay when their teams play in other states. That seems fair enough, given the megamillions pro athletes earn. But the dirty little secret of the tax world is that athletes get tougher treatment than other highly paid workers when it c to collecting taxes.

DUNCAN: *Extra tab*

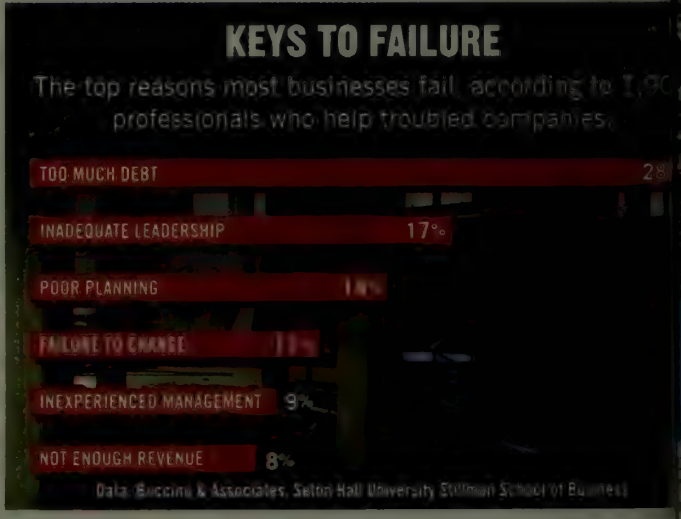
Twenty states have p special taxes that targe incomes of pro ath State officials contend the tax codes are blir profession. But when a pops in, enforcement t to be lax. reason the man gets ath is their sche are highly pu says David man, an econ at Washing Tax Foundat

Admittedly hard to wor a lot of out on behalf of paid athletes. what's good the ballplayer ought t good for the CEO. T just playing by rules. *Mark Hy*

THE BIG PICTURE

KEYS TO FAILURE

The top reasons most businesses fail, according to T professionals who help troubled companies.



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Editor's Memo

TECHNOLOGY: THE COMING REVIVAL

Dragging itself out of three years that were simply awful, the information technology industry is debating whether it has become, in fact, mature—that dreaded word. Nicholas G. Carr poked a stick in the eye of techies everywhere in his controversial *Harvard Business Review* piece in May, "IT Doesn't Matter." We beg to differ. Our summer double issue, "The Future of Technology," checks the vital signs. Instead of a mature industry, we see advanced youth. In other words, plenty of room to grow.

In the same way we anticipated the tech-led recession ("The next downturn," Cover Story, Oct. 9, 2000), this year we heralded emerging bright spots, such as the Wi-Fi explosion and an e-business revolution that continues to deliver on the promise of the Internet, despite the bubble. How about eBay Inc., which did nothing less than invent a whole new business world, with few restraints on its ability to grow? Or take heart from Intel Corp. Chairman Andrew S. Grove, a 40-year tech veteran, who says: "The rate change in technology is as much today as any time in my experience."

Sum it all up, and we see a gratifying tech revival—not a boom, mind you, but good, solid growth. And we present a road map that suggests some directions.

OCT. 9, 2000 **APRIL 28, 2003** **MAY 12, 2003**

We don't say it will easy. Spar piracy, pri vacy, and security problems, unresolved could endan ger the recovery's momentum. This year's double issue the combined effort of our technology, economics and finance teams, all led by Assistant Managing Editor Kathy Rebello, who divides her time between Silicon Valley and New Yor Special credit goes to Silicon Valle Bureau Chief Robert D. Hof, Seni Writer Stephen Baker in New Yor and art directors Steve Taylor and Ron Plyman.

There's plenty to ponder.

Stephen B Shepar

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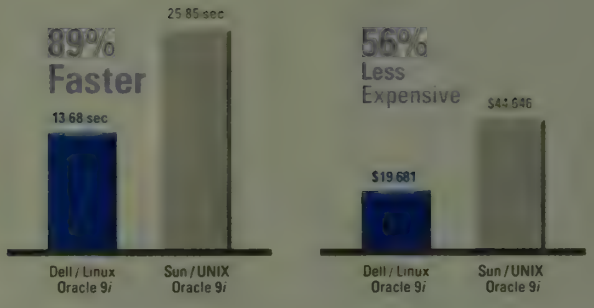

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eaders Report

BOUT CITI, Y, AND CHUCK

ti's new act" (Cover Story, July lls us that Sanford I. Weill's suc-, Charles O. "Chuck" Prince, through the ranks, starting as cor- counsel." Somehow that doesn't quite the same Horatio Alger "hardship to head-of-ship" ring to it as the traditional "rose through the ranks, starting as messenger." Corporate counsel is not an entry-level position—in anybody's corporation.

Wes Pedersen
Public Affairs Council
Washington

a former employee of Citicorp, I r why you (and others) say about Weill that he "created a global house" and "built Citigroup into orld's most profitable company." cts show that Citigroup is mainly rmer Citicorp that was built by Wriston, John Reed, and the sen- nagement that worked with—and —them, together with hundreds usands of employees. Weill merely vered himself to the chairmanship ticorp by combining it with his lers Group, taking over the combi-, and then selling Travelers.

George Roniger
Larchmont, N.Y.

n say, "Chuck Prince, Sandy Weill's oubleshooter, is the unlikely choice ome CEO. Does he have the right to lead the world's most impor- ank?" Nice touch! How about giv- e guy a chance? Is it possible that and Citi's board of directors know than *BusinessWeek*?

Harry Pelton
Palm City, Fla.

SEC VS. THE AGs: R OF THE WATCHDOGS

all for effective and tough regu-, but letting 50 attorneys general their way with American business the answer ("States vs. the SEC: 's all the shouting for?" News: sis & Commentary, July 28). It is enough for a company to satisfy ecurities & Exchange Commission, ederal Trade Commission, and the e Dept., and probably the Euro- Union every time it makes a move. To have to deal with 50 states on top of that is ridiculous. The motives of the states are certainly questionable. Look at what they did with the money from the tobacco settlement. Instead of paying for health costs and antismoking programs, most states just used it to fund their spendthrift programs.

Jay Goldberger
New York

The SEC's problem is that it is powerless to take any action that offends so-called "business groups" that own (or lease) a congressman or so. It doesn't take long for even the most impassioned enforcer to realize that there's not much upside in going after the really big bad guys or the real problems. The ability of state attorneys general to take over the role abdicated by the SEC was probably more due to their prior invisibility than anything else. Now that those who regard securities laws as an inconvenience or meddlesome intrusion on free markets know that they have another group of policemen to neutralize, you can assume that they'll be working on that project. Which will leave us with only the class action lawyers to worry the fast-buck crowd. Not exactly the guys you would hope to see with a sheriff's badge, but it's what's left.

Arthur O. Armstrong
Manhattan Beach, Calif.

CHINA'S EXCHANGE RATE: MORE THAN MEETS THE EYE

I have been amused every time a reporter or expert writes about the need for China to revalue the yuan without knowing the Chinese psyche. The latest offerings are "How China is threatening a global recovery" (Economic Viewpoint, July 21) and "Should China revalue? Soon, it may have no choice" (International Business, Aug. 4). The yuan was pegged at 8.28 to a dollar, and it was not an arbitrarily chosen number. To the Chinese, 8.28 sounds like "prosperity brings more prosperity." So far, it has been true. So why bother to change something that has worked extremely well? Imagine if it were to revalue and double its value, to 4.14 to a dollar. This would just be terrible, because 4.14 sounds like "die, and die once more."

James S. Ang
Florida State University
Tallahassee, Fla.

Is Jeffrey Garten seriously asking another country to revalue its currency, hoping it will sort out the U.S.-EU-Japan mess? China is already helping

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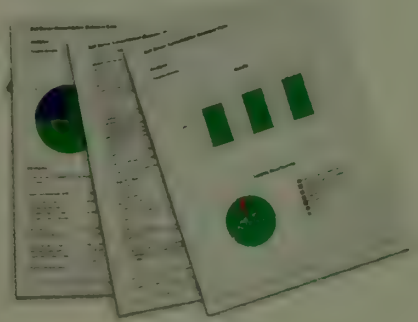

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A lot of companies are using cameras these days. But only GM is using one like this: a high-powered, ferroelectric heat-sensing camera – aka, Night Vision. Offered exclusively in the Cadillac DeVille, this first-of-its-kind feature harvests thermal-imaging technology from the military to help drivers see beyond the range of low beam headlamps. By projecting infrared images onto the windshield, Night Vision can give drivers some extra time to react.

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Readers Report

CORRECTIONS & CLARIFICATIONS

"The problem of the 'lingering CEO' " (News: Analysis & Commentary, July 28) erroneously reported that the former chief executive officer of Maytag remained on the company's board after retiring as CEO. Leonard A. Hadley left the board in August, 1999, after turning the company over to Lloyd Ward, then returned as both CEO and a director in November, 2000.

"Global Crossing: A matter of national security" (News: Analysis & Commentary, Aug. 4) incorrectly described Carl J. Grivner as the former CEO of Global Crossing. He was the chief operating officer. And it misspelled the name of the CEO of Precursor Group. The correct spelling is Scott C. Cleland.

In "Figures of the Week" (BusinessWeek Investor, July 28), the total returns for Driehaus European Opportunity were incorrectly stated. The correct four-week return was 0.0%, and the correct 52-week return was 26.2%.

the U.S. dollar by having the world's second-largest foreign-exchange reserve of $347 billion. In other words, Garten suggests that China should revalue in a big way, then watch foreign investors flee, ignore the resulting crisis in China, and keep its dollars locked away.

Bouko J. de Groot
Hengelo, The Netherlands

GENERAL MILLS SHOULD JUST DO IT

General Mills Inc. (and others) should eliminate the cereal box and replace it with a plastic bag ("Thinking outside of the cereal box," Management, July 28). This would save a third of the bulk, reduce shipping costs, save storage space and restacking time, and reduce the retail price to the consumer. I suggest that General Mills start leaving the box out of their thinking and bag it!

W. H. Mayfield
San Diego

General Mills Chief Technical Officer Randy G. Darcy really needs to focus on is the implementation of his benchmarking "discoveries." Minneapolis is teeming with companies effectively implementing lean manufacturing, theory of constraints, Six Sigma, and other enterprise-wide improvement techniques. Less focus on "discovering" big ideas and more on execution of good business practices might serve General Mills a whole lot better. And although it doesn't compare to a company-paid junket, achieving sustained, double-digit productivity gains is actually pretty fun.

Bill Rose
Minneapolis

THE LONELINESS OF THE SINGLE WORKING MOM

I read with great interest your profile on GE Transportation Systems President and CEO Charlene Begley ("Crashing GE's glass ceiling," People, July 28) and also the results of the careerbuilder.com survey ("The mommy ladder," Dividends, July 7) that reported that 71% of full-time working mothers don't feel they've had to sacrifice job advancement as a result of motherhood. I suspect that most of the respondents in that survey had something in common with Begley: a supportive husband. For the many of us who are single full-time working mothers, the story is much different. Please give us a more realistic example.

Lesley Bass
Montgomery, Ala.

"Crashing GE's glass ceiling," while very well written, took an undeserved swipe at Erie, Pa., and cities like it. Erie is a solid community and home to thousands of hard-working people, good companies, universities, teaching medical facilities, seven miles of sandy beach, and houses you can afford. Erie is not "bleak" by any stretch of imagination.

Kevin J. O'Connell
Erie, Pa.

TAKING STOCK OF INSIDE WALL STREET

"Inside Wall Street: A report card" (Finance, July 28) seems overly generous to Gene Marcial's stockpicking prowess. The initial price that you use is from the close on Thursday prior to the article being available. Should you use the opening price on Friday, or an average price from Friday, the results would be considerably worse. No doubt in the area of 2.8% worse (the average first-day gain).

Marc Jacobs
Poway, Calif.

Marcial is actually a major cause of the one-day advance, and the best way to use his recommendations is to short the stocks he recommends after the first day of artificial gains and ignore the ones that don't go up that first day.

Arthur M. Field
Easley, S.C.

BAR CODES AREN'T OBSOLETE YET

Radio frequency identification (
technology is not remotely close to
viding the individual product trac
suggested in "Bar codes better w
their backs" (News: Analysis & C
mentary, July 14). Each retail shelf w
need a reader costing hundreds of do
Manufacturers won't want to add 10
to each item they sell. The frequen
question, 915 MHz, operates at se
meters of range, which makes moo
suggestion that this technology ma
used during cashier checkout. Wal-
Stores Inc. will be attempting to tag
lets, bins, and totes that come an
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facilities—identifying larger quantiti
items, not individual toothbrushes.

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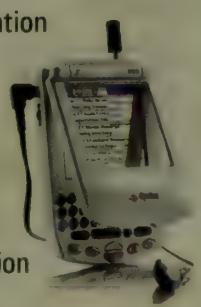

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BY ROBERT J. BARRO

WHY THE SECOND HALF LOOKS MORE SOLID EVERY DAY

STRONGER: Bigger defense outlays, improved global security, and economic stimulus should keep fueling a U.S. recovery

Economic growth, at an annual 2.4% rate in the second quarter, came in stronger than many expected. Looking ahead, I concur with the consensus forecasts of even better growth for the rest of the year and into 2004. A number of factors are contributing to the improved economic environment.

One is the defense buildup. As a consequence of the conflicts in Afghanistan and Iraq, defense spending is $76 billion higher in 2003 than it would otherwise have been before September 11. It is up 25% over 2001. U.S. history indicates that each real dollar of this kind of military spending raises real gross domestic product by about 75¢. That yields a contribution to 2003's real GDP of $57 billion, or 0.6% of GDP. In standard economic jargon, the 75¢ number means that the "multiplier" on defense spending is 0.75. I arrived at that number by studying large U.S. wars and isolating the economic effects of defense spending—a relatively straightforward exercise. At the peak of World War II in 1943-44, the extra real defense spending was an astounding $540 billion, and this raised real GDP by $430 billion. For every defense dollar spent, real GDP rose by 80¢. So the multiplier was 0.8. About the same proportionate effect on GDP arose during the Korean War, but a smaller multiplier showed up in World War I. If I average these three wartime experiences, I get the 75¢ number that I used for my estimate. Some other past conflicts did not yield reliable information for my study, such as Vietnam, Gulf War I, and the Spanish-American War. (The results would be different for wars that destroyed productive capacity, such as in Europe in World War II or in the U.S. in the Civil War.)

Prospects for higher economic growth may also be enhanced by the improved international security derived from the overall success of military operations in Afghanistan and, especially, Iraq. The mostly favorable resolution of the war in Iraq contributed to the strong performance of the U.S. stock market over the past several months. And stock market returns are a pretty good predictor of economic growth.

Of course, the stock market and the economy are also benefiting from the recently enacted tax-cut package. Unlike the tax cuts of 2001, this one provides significant incentives for investment, productivity, and employment. The pickup in private fixed investment in the second-quarter GDP numbers may already reflect these tax changes.

Growth will also benefit from a monetary policy that remains highly stimulative, with s term nominal interest rates barely above More relevant for the economy, however longer-term interest rates. To think abou long-term rate, it is useful to distinguish real interest rate from the nominal interest Fortunately, with the existence of indexed Treasury bonds, called TIPS (Treasury Infla Protected Securities), it is easy to do this.

TIPS adjusts the return for inflation. It you an insight into what the market thinks i expected inflation rate. For example, at the of July, the 10-year U.S. Treasury bond yielding 4.4%. That is the nominal interest At the same time, the 10-year TIPS was yie 2.4%. That tells us the real interest rate. Loo back, this real interest rate peaked at 4.3 the end of 1999, pretty much along with economy, and then went into a precipitous reaching its low of 1.5% in mid-June of 2 The main thing we should read from such a real rate is that investment prospects wer weak that they justified a prospective real ra return over 10 years of only 1.5%. From same perspective, the 4.3% real rate at the of 1999 was a sign of good times—because prospects for investment and growth were st enough to warrant such a high prospective rate of return.

The rise in the real interest rate from 1.5 mid-June of 2003 to 2.4% at the end of Ju thus a very positive development. It indic that investment prospects are improving. doubt, if investment picks up and the econ grows briskly, real interest rates will adv further, and no one should be upset about

The other part of the interest-rate pictu the expected inflation rate, which we can c late as the difference between the nomina terest rate and the real interest rate. W computed this way, the expected inflation has remained in the vicinity of 2% over the riod since 10-year Treasury indexed bonds first issued in early 1997. The expected infla rate did rise at the end of July from 1.7% in June. But this small change should have consequence for the economy. In fact, the s rise in expected inflation is welcome in the of all the worry over deflation.

In the end, it is up the Federal Reserv ensure that expected inflation does not rise a above 2%. Sound monetary policy, combined higher defense spending and big tax cuts, sh ensure America's return to strong econo growth.

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).

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BWK8/03

Positioning Strategies for Energy Independence

A variety of fuel sources and technologies are being exploited to help us reach indepen

Given the upheaval in the energy marketplace these past two years, one might get the impression we are in deep trouble. Headlines proliferate about energy trading and accounting scandals, California in crisis, natural gas shortages and stock and credit devaluations. Obviously good news doesn't sell; but rest assured, there is plenty of good news.

From the gasoline shortages of the early eighties to natural gas and electric deregulation in the nineties, energy companies have been modifying their strategies to assure energy supplies meet market demands. The marketplace has experienced large consolidations, such as Exxon-Mobil and BP-Amoco. At the same time, we have witnessed thousands of entrepreneurial start-ups, such as Clean Air Partners and GlobalView in technology, and ACN Energy and Energy America in retail markets. According to ACN Energy CEO, Chip Barker, "Our unique personalized approach to commercial and residential energy customers has resulted in strong growth in the deregulated markets."

Even utilities have undergone significant repositioning in the past decade. For example, PSEG, the largest utility in New Jersey, is now three distinct business units instead of one. These units are the traditional regulated utility, the non-regulated power generation unit, and the international energy unit. By following a strategy of focusing on its core markets and diversifying its portfolio, PSEG has maintained a strong position. According to PSEG's CFO, Thomas O'Flynn, "Our strategies have resulted in both our shareholders and our customers benefiting. Customer rates, including the revisions this summer, are slightly below 1999 levels, while our shareholders have enjoyed steady dividends and earnings growth."

Deregulation creates abundant opportunities to take control of energy. One example of deregulation creating energy independence for consumers is PSEG and other New Jersey utilities' installation of hourly electric metering technology for their industrial customers. This investment, in concert with new rate structures approved by the New Jersey utility commission, has enabled industrial customers to buy electricity in the wholesale markets. These changes will foster economic incentives for shifting consumption patterns by promoting conservation during peak periods, which results in a more efficient grid that requires fewer power plants, ultimately reducing emissions.

Energy companies have been modifying their strategi to assure energy supplies meet market demands.

Proof that deregulation works can be found in the fact that PSEG utility customers will no longer pay about $30 million annually in nuclear decommissioning charges. In addition, PSEG has invested approximately one billion dollars in more efficient gas generation in New Jersey that is not underwritten by ratepayers. O'Flynn indicates, "We are pleased that the long path to deregulation in New Jersey is almost at an end and has gone very much accordi plan." PSEG and New Jersey provi model that demonstrates how ele and gas deregulation can work han hand to promote energy independe

Energy companies and consu alike are investing in new technolo and processes to manage the grow demands of the marketplace. Clean technologies, imported liquefied n al gas, wind generation and ever-de offshore drilling technologies are use today. Improvements in informa processing are serving to stream operational efficiencies to cut cost across the value chain on both the ply and demand sides of the equat

There is even good news in s areas of recent turbulence. Energy ing, in its redefined role of the merc and risk management function, is sh ing positive signs. PSEG's O'Flynn s "Our trading business has added n estly to profits while performing its mary function of reducing portfolio and volatility."

If history repeats, the energy indu will emerge from turmoil stronger t ever, and in so doing provide unprecedented era of energy indep dence for consumers.

This special advertising section was written by Weigand, CEO, Skipping Stone, Inc., an energy sulting firm with practices across the energy value chain.

www.skippingstone.com

GAME PLAN

[ANOTHER REASON PSEG HAS WALL STREET'S ATTENTION]

In the end, the team with the most runs, not home runs, wins. That's been our game plan at PSEG for one hundred years. Our corporate style is to stick to what we know best. We go for singles and doubles. Rather than swing for the fences. Besides, our portfolio of businesses gives us a balanced lineup of performers, including a New Jersey utility, a Northeast generating company and other energy related businesses. And as our overall earnings record suggests, good things happen when you cover all the bases.

PSEG
We make things work for you.

www.pseg.com

ALL THE SHAH'S MEN
An American Coup and the Roots of Middle East Terror
By Stephen Kinzer
Wiley • 258pp • $24.95

THE REGIME CHANGE THAT BACKFIRED

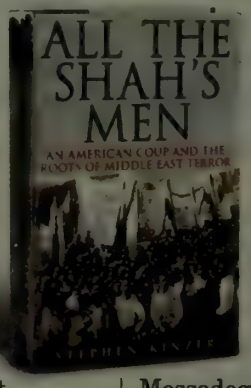
With American and British troops occupying Iraq and the Bush Administration rattling its sabers at Iran, Stephen Kinzer's entertaining and sometimes shocking *All the Shah's Men* is timely indeed. Focused on the 1953 U.S.-sponsored coup in Iran, the volume serves as a useful reminder that troublesome regimes do not come out of nowhere. Rather, the U.S. and Britain have at times helped construct them.

The overthrow of Iran's nationalist Prime Minister, Mohammad Mossadegh, ranks with the 1956 Suez Crisis as a landmark in the history of relations between the Middle East and the West. Egyptian President Gamal Abdel Nasser's defiance of the British and the French helped to build an international anticolonialist movement. However, Mossadegh's unsuccessful face-off with the West led to a quarter-century of American domination, through the despotic rule of the Shah of Iran. The Shah was finally forced to leave in 1979.

All the Shah's Men sheds valuable light on the events of 1953, drawing on scholars' work and on the CIA's secret history of the coup, leaked to *The New York Times* in 2000. Central to the tale is Mossadegh, one of the more peculiar political figures of the 20th century.

Elected to Iran's first Parliament in 1906, this son of a princess was in and out of government—more than once withdrawing because of objections to the country's brutal and corrupt rulers. After two decades in retirement, he made a comeback in the relatively free parliamentary elections of 1943. He was many things to many people: U.S. officials found him "witty," "affable," and "honest," while British diplomatic cables called him a "wily Oriental" who "looks like a cab horse." Above all, Mossadegh was a man of high principle. This set him on a collision course with the big powers and especially with Anglo-Iranian Oil Co. Anglo-Iranian, which developed Iran's reserves, enjoyed an enormously favorable position in Iran, paying the government only around 15% of the tens of millions in revenue.

Abadan, the company's center of operations, was "a classic colonial enclave," Kinzer writes. British administrators "enjoyed handsome homes with terraces and manicured lawns." Iranian workers "lived in slums and long dormitories with only primitive sanitation." At one point, there were public "water fountains marked 'Not for Iranians.'"



Various Iranian attempts to renegotiate the terms of the oil concession failed, largely because of the stubbornness of the company, which the British government backed unhesitatingly. In 1951, Iran's Parliament elected Mossadegh Prime Minister with a mandate to nationalize the oil company. That set up a "clash of titans," writes Kinzer: On one side was "Mossadegh, the symbol of Iranian nationalism and resistance to royal power," and on the other, the British along with Shah Mohamad Reza Pahlavi, the man they had installed.

The Americans thought the British were wrong in not trying harder to cut a deal with Mossadegh. After all, during the same period, U.S. oil companies had struck a 50-50 profit-sharing arrangement with the Saudis. "We tried to get the blockheaded British to have their oil company make a fair deal with Iran," lamented President Harry S Truman.

But Mossadegh's 1951 nationalization was too much. The British discouraged potential customers from buying Iranian oil, and their secret services began plotting Mossadegh's fall. They found willing accomplices in the Eisenhower Administration, which came to power in 1953. British spymaster "Monty" Woodh won the U.S. over by arguing Iran's increasingly chaotic situ made it ripe for a coup by the co nist Tudeh Party, which could draw port from the Soviets right next Soon, Kermit Roosevelt, grandso Theodore and the CIA's Middle chief, was on his way to Tehran.

In Kinzer's work, Roosevelt bec a figure out of spy fiction: While pl Mossadegh's ouster, he held regular night rendezvous with the Shah, s ing into the palace under a blank the floor of a car sent by the mon Roosevelt's first coup attempt, on 15, 1953, was foiled by loyalist arm ficers. Ignoring his bosses' urging flee, the CIA man opted to try a Mossadegh's naivete and decency p into Roosevelt's hands: The Prime ister felt there was no need for fu vigilance since the Shah, whom thought had been behind the coup, fled to Rome.

In a cynical ploy, Roos sent U.S. Ambassador Henderson to complain, f ly, to Mossadegh that A cans in Iran were being rassed. Abashed, Mossa ordered a brutal crackd on his own supporters, c ing the streets for Roose successful military putsch next day, Aug. 19.

After three years in pr Mossadegh spent the rest of his life der house arrest at his country es He died in 1967. Roosevelt died in believing the coup "right and necess Instead, Kinzer argues, the U.S. and world have paid a stiff price. The S bloody and dictatorial rule created e mous pent-up anger, which led to a ical Islamic regime bent on punis the U.S. Because Ayatollah Khom proved such an inspiration for Isl militants elsewhere, Kinzer says, " not far-fetched to draw a line from eration Ajax [the coup] through Shah's repressive regime and the Is ic Revolution to the fireballs that gulfed the World Trade Center in York." That may be going too far, certainly Kinzer's book should give p to would-be regime-changers.

BY STANLEY R

London Bureau Chief Reed co the Middle East.

KINZER ARGUES THAT THE U.S. AND THE WORLD HAVE PAID A STIFF PRICE FOR MEDDLING IN IRA

Who decided adults have to learn in rows?
Say goodbye to the way things were. Now there's adult education actually designed for adults. Imagine that. Our interactive online format is both stimulating and built around your schedule. It's a revolution in education. To learn about our bachelor's, master's and Ph.D. programs, call 1-888-CAPELLA ext. 6117 or go to www.capella.edu/desk26
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pella University is ac ited by the Higher Learning Commiss (HLC), the same body that accredits Big Ten universities.

This is part of the Heidrick & Struggles' SAGE series (Strategic Advice on Governance and Executives).

How to Partner with an Executive Search Firm

By
Dale E. Jones
Managing Partner, Southeast
and
Lee Hanson
Managing Partner, San Francisco
Heidrick & Struggles

The pace of change in business has accelerated dramatically over the past decade, and promises to continue on its present course. During this time we have all become familiar with the speed at which a company's well-being and leadership needs can change as new competitors arise, customer preferences shift, and alternative technologies emerge.

The search for an executive can either intensify the potentially destabilizing effects of today's business climate or provide the opportunity to turn them around for competitive advantage. The difference relies upon the ability to accurately assess the current leadership gap, and to fill this gap within the context of longer-term organizational needs, structure and culture. This skill is powerful when it emanates from within a long-term partnership between executive search firm and client. It is, in fact, the chief reason for their alliance.

"The success of any relationship is built on the depth of communications, understanding, common values, and trust. This is certainly true between executive search firm and client, where the outcome is profoundly affected by the quality of the collaboration."

Our previous article in this series, *How to Select an Executive Search Firm* (August 4), detailed why companies enlist executive search firms, and offered guidelines for companies to ensure that the evaluation and selection of a search firm concludes advantageously for their needs. Now we turn to the following phase: the partnership between client and search firm to identify, select and recruit talented individuals.

Building Effective Leadership Teams

The best executive search firms do not treat engagements as stand-alone assignments to be dispatched hastily; nor should a client organization consider the search firm an entity hired only to perform a single task and make its exit. Throughout our 50-year history, Heidrick & Struggles has practiced a consultative approach to executive search. Both parties are best served by fostering a long-term relationship with the mutual goal of securing the best candidate for the current opportunity, and of building effective leadership teams over time -- teams from which competitive advantages can emerge.

To accomplish these immediate and longer-term goals, every executive search demands satisfaction of unique requirements and points of emphasis. Still, most searches progress through five general phases. Each phase presents a opportunity for client and executive searc firm to share and integrate their own pe spectives and best practices into the proces The pace at which these phases progress i dependent upon numerous factors.

Organizational Review

The initial consultative phase is arguabl the most important in executive searc engagements. A thorough due diligence an needs assessment on the client organizatio is vital to achieving a positive and successfu search outcome. During this phase, th search team meets with Search Committe members, select board directors, senior mar agement, departmental directors, and/o other relevant stakeholders to gather information on the company goals, strategies and culture. The search consultant and client the partner to create specifications for the desired position. A goo search firm leverages its experience with previous engagements t assist the client in assessing the demands, qualifications and expec tations of the position in light of marketplace realities.

Further, expectations regarding the candidates' backgrounds abilities and competencies, potential compensation arrangements and related information are discussed indepth. Finally, industr segments likely to yield appropriate candidates are identified an reviewed. At this time, viable internal candidates may be identifie and included in the evaluation phase.

Candidate Identification and Review

Based on the position specifications and the client's stated criteri and preferences, the search firm then identifies an initial slate of qual ified candidates from among its network of executives. It may als survey its own global consultancy for input on appropriate and poten tially interested candidates, or candidates who may be content in thei current situation but would serve well if given another opportunity Each candidate is considered for pertinent experience, skills an cultural fit. Suitable candidates are approached by the search firm directly and confidentially, to gauge interest and career goals.

A high level of familiarity and access to the market's mos talented and experienced individuals provides a clear advantag

e, for a candidate's response to a uiter's call and receptiveness to an opportity is key. Many search firms claim this l of access and influence; only a few can ually deliver.

uring this time – and throughout the agement – the client should contact the rch firm if additional or different information concerning the position emerges. most capable search firms can adjust r approach accordingly with impressive rity. Upon conclusion of this phase, the rch firm typically delivers a full status ort to the client.

Candidate Interview and Presentation

his phase of an executive search is where a rch firm and its consultants add the most e. Gleaning the knowledge about the client pany, and drawing from years of experie in assessing executives' credentials, their ity to transfer skills, and their capacity to tively impact a business, the search's lead sultant now embarks upon a series of nsive interviews with internal and external didates, and assesses in detail the skills, rest level and cultural fit of each. Only the t qualified candidates may be presented to client, or the client may choose to review all ssments. In either case, a select group of didates is invited to meet with the client.

p-tier search firms facilitate interview sched- g and handle all logistics such as travel ngements and candidates' travel expenses. during this phase when the timeframe of a ch is most affected since interviews are sub- to client and candidate availability.

Candidate Selection and Tender of Offer

ient participation is always important. at this stage, client input and decisions paramount. The search consultant ainly helps the client work through the sion-making process, but the final deci- always rests with the client. The client res with the consultant all interview feed- k, which the consultant augments with lysis of each candidate's strengths and ity to meet the company's current and re needs. If additional candidates are red, the search firm identifies and presents n on an accelerated schedule. Educational entials are verified before candidates are sented to clients, but as soon as a clear ice emerges, formal reference checks are formed and reported by the search firm.

p-notch search firms also provide input on andidate's desired compensation, and st the client in formulating an offer, presenting it to the candidate, and negotiating its acceptance. Should extensive, complex negotiations be required, the client and search firm may choose to tap an outside compensation consultant until an agreement is reached.

Transition, Closure and Follow-up

This final phase includes assistance from the search firm in transition planning and executive integration, if needed. Most search firms also conduct a closing review to gauge the client's perceptions and level of satisfaction. As part of a consultative approach to executive placement, follow-up can continue through whatever time frame is mutually acceptable.

The best search firms also offer related services such as professional development and executive assessment to support the new executive's integration into the client's organization. For example, professional coaching for at least the executive's first 100 days is increasingly chosen by companies as a way to protect their investment in the new executive.

Heidrick & Struggles as Your Partner

The success of any relationship is built on the depth of communications, understanding, common values, and trust. This is certainly true between executive search firm and client, where the outcome is profoundly affected by the quality of the collaboration. Because of the enormous impact an executive search can have on an organization, the search for new talent should stem from such a relationship – a relationship of mutual understanding, respect and trust that grows in strength and effectiveness with each new engagement.

Of the thousands of searches we conduct worldwide each year, the majority are for clients previously served. We believe that our clients' continued reliance and trust is evidence that our candidates consistently meet or exceed all expectations for personal characteristics and professional abilities. Each subsequent search builds upon the previous one, creating over time a strong foundation that helps our clients not only to compete in today's marketplace, but also to win.

Heidrick & Struggles: The Value We Provide

We are rigorous throughout the search process to ensure that we maintain high standards of excellence. An emphasis on quality is at the forefront of every search we conduct.

Our reputation as the premier resource for executive search and leadership consulting services is founded on the value we provide to clients through a consultative and professional approach to the executive search process:

Access and Knowledge
A global network of consultants possessing geographic, functional and industry expertise.

Skill
A demonstrated ability to assess and recruit executives across all industries.

Resources: Comprehensive Analysis
An objective analysis of the required skills and competencies for a given position using state-of-the-art assessment tools, proven interview techniques, appropriate sourcing and professional referencing.

Solutions: Insight and Judgment
An intrinsic understanding of the values and critical success factors required to successfully complete each assignment as well as to build upon for a long-term, mutually beneficial partnership.

This is our competitive advantage in the field of executive search firms. We invite you to consider making it yours as well.

50 YEARS EXECUTIVE SEARCH

Heidrick & Struggles International, Inc. is the world's premier provider of executive search and leadership consulting services. Currently, approximately 1,300 Heidrick & Struggles search professionals and employees operate from locations primarily in North America, Latin America, Europe, and Asia Pacific. For 50 years, Heidrick & Struggles has specialized in chief executive, board member and senior-level management search assignments for a broad spectrum of clients: multinational corporations, mid-cap and start-up companies, nonprofit entities, educational institutions, foundations, associations and governmental units. The company is expanding its range of complementary services to offer solutions to senior management teams for their leadership needs, including recruitment of emerging talent, executive assessment, interim executive placement, and professional development.

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For more information about Heidrick & Struggles, visit www.heidrick.com or email CEO@heidrick.com.

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AMES C. COOPER & KATHLEEN MADIGAN

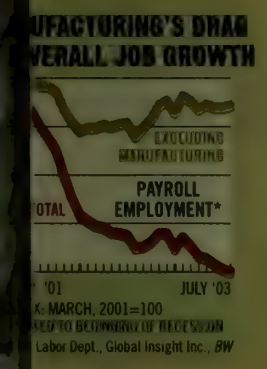
YAWNING TRADE GAP OULD SWALLOW THE RECOVERY

onger demand will lift imports as weakness abroad pummels exports

U.S. ECONOMY

After a year and a half of fits and starts, the U.S. economy y seems on its way to a real recovery. Heading the second half, consumers are spending more . Businesses are loosening up their capital budgets, skimpy inventories and rising orders are lifting trial activity. Sounds promising, right?

t there's a catch. True, the outlook for U.S. de- is the brightest in years, as tax cuts, lower in- t rates, healthier financial conditions, and reduced tainty work their magic. But overall demand is ng little help from outside the U.S., and much of ickup in American spending is going to imports. question: Can the U.S. be the locomotive for world th without derailing its own recovery?



Stronger U.S. demand amid stubborn global weakness is almost certain to cause the trade deficit to balloon further. A widening trade gap, which subtracts from real gross domestic product, may rob the economy of that extra dollop of growth so crucial to capital spending and hiring—the two requirements for a lasting recovery.

Because the volume of U.S. has doubled in the past decade, the U.S. is much globally integrated and dependent on foreign de- . At the same time, America has dramatically oved its ability to grow faster, while other na- have not. The paradox here is that, until the of the world catches up, there is a built-in ten- for the U.S. trade deficit to grow. That's a key rability for future U.S. growth, especially since ica will have to find the funds to finance both an ding budget deficit and a record trade gap.

LATEST DATA ILLUSTRATE what growth is up st. In the second quarter, real GDP grew at an an- rate of 2.4%. U.S. exports fell for a third consec- quarter, as imports surged. Without the sharp ing in the trade deficit last quarter, the economy l have grown 1.6 percentage points faster. t extra growth would have been sufficient to rt more jobs, especially in the trade-sensitive facturing sector (chart). But in July, payrolls fell e sixth month in a row. Since the recovery began, in late 2001, the economy has grown at an annual rate of 2.6% but has lost 1 million jobs. Excluding the $128 billion increase in the trade gap, growth would have been 3.2%, a clip that would have stanched those payroll losses and maybe even allowed for some gains.

This leakage of U.S. demand to foreign producers would normally help to strengthen a struggling global economy. Indeed, key U.S. trading partners such as Canada, Mexico, and Emerging Asia will benefit, and the reciprocal boost for American exports to those areas will eventually help the U.S. However, Japan and Continental Europe face structural rigidities in labor and financial markets that are limiting their growth, and imports from China are a growing challenge to U.S. producers.

In fact, a U.S.-led recovery may worsen an already-alarming global trade imbalance instead of helping to repair it (chart). The U.S. current-account deficit, the broadest measure of the trade imbalance, appears to have risen to a record 5.4% of GDP last quarter. Most economists believe this level is unsustainable, especially at the current level of the dollar. A weaker dollar helps exports and deters imports, but amid brighter prospects for stronger U.S. growth, the trade-weighted greenback has started to rise again in recent weeks, after declining 9% from its early-2002 peak.

BY MOST MEASURES, the economy is looking better this summer than it did last winter—but how much better? And how much momentum will the economy carry into 2004? With long-term interest rates rising, with housing peaking, with the refi stimulus set to wane, and with businesses so keen on boosting productivity instead of payrolls, a widening trade gap would be one more potential drag on growth.

The second-quarter GDP data showed a solid 3.3% growth rate in consumer spending, and a surprisingly strong 6.9% increase in business outlays for new equipment and buildings. Housing also posted a solid gain of 6%, fueled almost completely by spending on remodeling, thanks to the refi boom. Plus, the momentum building in the spring is carrying over into the third quarter.

Note, however, that a 44% surge in defense spending

related to the Iraq war, which was the largest quarterly rise since the Korean conflict, accounted for a disproportionate 1.7 percentage points of the overall 2.4% gain in GDP. Without that boost, which won't be repeated to that degree in coming quarters, real GDP would have grown only 0.7%, which makes the impact of the wider trade deficit even more dramatic.

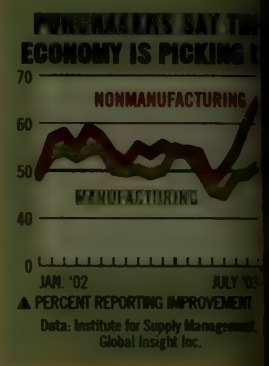
One negative in the second-quarter GDP data will actually be a big positive for the second half. Business inventories shrank by $17.9 billion, the first liquidation in more than a year. Given recent signs that both production and demand are picking up, that drawdown appears to have taken businesses by surprise. Reordering will generate output gains in coming months as businesses scramble to replenish their stocks.

THE NEW BUSTLE in business activity shows up in the Institute for Supply Management's July reports on both the manufacturing and nonmanufacturing sectors (chart). The ISM's index of industrial activity rose to 51.8%, the first time since February that the reading has exceeded 50%, the dividing line between growth and contraction. But the real zip was in nonmanufacturing, mainly services, where the ISM's index shot up to 65.1%, the highest level in its six-year history.

The trade deficit, with its disproportionate impact on manufacturing, results in a stark contrast between manufacturing and the rest of the economy, where trade patterns have less of an influence. And the tory sector's toll on the economy has been heavy.

Start with jobs. During the past year, overall priv sector payrolls are down 359,000, but that inclu manufacturing losses totalling 697,000. That means manufacturing jobs have actually increased by 338, Factories employ only 13% of all workers.

The factory slump is also hurting incomes. Overall wages and salaries, adjusted for inflation, have not grown in the past year, but outside of the factory sector, they are up nearly 1%. As for prices, consumer goods, excluding energy and food, show outright deflation: Prices are down 1.9% from a year ago. Meanwhile, service prices are up 2.9%.



But while manufacturing is at the eye of the tr storm, other sectors are also feeling the heat from creased global competition and the need to cut co and lift productivity, which posted an exceptiona strong gain last quarter. Companies' success will sh up on their bottom lines and in stock prices. Howe these pressures will place added stress on U.S. e ployment and incomes at a time when economies o side the U.S. are still struggling to recover.

FRANCE

A BABY STEP IN THE RIGHT DIRECTION

The French government is taking another step in reforming its economy. Amid heavy criticism, Finance Minister Francis Mer revamped a government-subsidized savings account called the Livret A.

As of Aug. 1, nearly 46 million Livret A accounts will earn interest at a rate of 2.25%, down from 3%. In the future, Livret A rates will be updated by the independent Bank of France based on inflation and short-term interest rates in order to depoliticize the rate-setting process. But the 4.25% rate for special low-income accounts, as well as the 15,000 euro ceiling per Livret A, will stay in place.

OVERHAULING LIVRET A

- LOWER LIVRET A SAVINGS RATES TO 2.25% FROM 3%
- ADJUST RATE EVERY 6 MONTHS
- RATE WILL BE BASED ON AVERAGE OF INFLATION AND SHORT-TERM INTEREST RATES, PLUS 25 BASIS POINTS
- CUT ADMINISTRATION COMMISSIONS IN HALF

Data: Morgan Stanley, BNP Paribas

The moves should end a quirk in France's financial system that "made the economy less sensitive to monetary policy than those of its neighbors," says Eric Chaney, a senior economist at Morgan Stanley. Lower rates make savings accounts less appealing and investments like houses or stocks more attractive. But as the European Central Bank cut rates over the past two years, tax-free savings accounts grew by more than 10%, to 257 billion euros, from the end of 2001 through May, says Chaney.

The reforms should have a positive, if small, influence on the economy. Some deposits will be withdrawn and spent. In addition, borrowing expenses for low-cost housing loans that use Livret A d posits will fall. That should spark additional investment in housing.

France's economy needs any help it can get. Consumer sentiment in July lingered at a weak –27. The number of unemployed rose by 11,000 in June. And econ omists have cut earlier growth expectations for 2003 by more than half, to less than 1%.

Reviving France's economy an reducing its large budget deficits will require more effort. Unfortunately, the center-right government may be losing its resolve. Plans to slash 30,000 civil service jobs turned into just 5,000 cuts. And on Aug. 5, the government said it would help bail out debt-laden engineering firm Alstom by buying a 30% stake in the company

By James Mehring in New Yor with John Rossant in Pari

©2003 Toyota Motor Sales, U.S.A., Inc. *Starting at MSRP includes delivery, processing and handling fee. Excludes taxes, license, title and other available or required equipment. Actual dealer price may vary. **2003 EPA estimated 24 city/33 highway mpg for Camry 4 cylinder manual transmission. Actual mileage may vary.

OUTSOURCING JOBS: IS IT BAD?

These are anxious times for U.S. workers. Sure, the recovery seems to be getting under way. Yet hardly a week goes by without another report of a batch of high-paying, white-collar jobs getting exported to far cheaper locales such as India, China, or the Philippines. In mid-July, IBM set off a firestorm when news of its plans to move more white-collar jobs overseas was leaked to *The New York Times*. And news service Reuters announced on July 28 that it will move 600 or so jobs from New York, as well as dozens of other slots in England, Scotland, and Singapore, to its operations in India.

As white-collar jobs move away with increasing regularity, a debate that once focused on the loss of manufacturing to foreign outsourcing is once again raging: Just how serious for America, its workforce, and its economy is the shift? Two decades ago, the loss of auto jobs and other high-paying manufacturing jobs sparked fears of a hollowing-out of the U.S. economy. Yet painful as the loss of those positions were, strong economic growth and innovation created far more—and better—jobs to replace them.

Now, the same process, many economists argue, is going on in services. Yes, some individuals are losing out as well-educated programmers or engineers can do the same job for far less halfway across the globe. But as the U.S. economy evolves, innovation will create new high-paying jobs. Others, though, argue that the outsourcing of highly skilled service jobs is fundamentally different—and poses greater risks for the U.S. economy. How worried should we be? Here are two opposing views:

YES... This is no longer about a few low-wage or manufacturing jobs. Now, one out of three jobs is at risk

MMENTARY

Kathleen Madigan

conomic evolution is inevitable. Companies will always pursue the lowest-cost structure, which means less skilled work will move out of the U.S. to emerging economies. And that's a good thing, because living standards around the world will rise. Workers in deing nations will get new and higher-paying jobs, and conrs in the U.S. will be able to buy products that are per than if they were made at home. The shift first ocd in textiles and other manufacturing jobs, followed by nd services such as telemarketing and data entry. Now, oving up the labor food chain, leaving white-collar workncreasingly nervous.

the angst justified? It's probably too early to know for whether this latest shift in jobs is qualitatively different past offshore movements. But it certainly feels that Outsourcing is hitting skilled jobs that were once ht "safe" across a far wider swath of white-collar America. What's more, the new outsourcing is occurring at a breathtaking pace. Only a decade ago, writing computer code and software-application maintenance were considered complex and secure ways for aspiring Americans to make a living. Now, it's considered "rote work," and companies such as Microsoft Corp. and Netscape Communications Corp. have it done everywhere from Ireland to India.

The extent to which industries are moving a wide array of mid-level professional jobs offshore is troubling. We're talking about computers and other high tech, business services, and finance. Add those industries up, along with factory jobs, and you find that one out of three private-sector jobs is now at risk of being outsourced. And that doesn't count back-office functions such as accounts payable, marketing and sales, and human resources that exist in U.S.-grounded industries such as retailing, health care, and recreation. All of them could be shipped overseas in the name of cost-cutting.

From just-in-time inventories to nanosecond technologies, business practices now turn on a dime. As soon as work can be made routine—whether it's reading an X-ray or creating blueprints—the job can potentially be outsourced. That promises ▶

...NO America's strongest suit is innovation, which will always create new high-paying positions

MMENTARY

Michael J. Mandel

hink of the world economy as a ladder. On the bottom rungs are the countries producing mainly textiles and other low-tech goods. Toward the top are the U.S. and other leading economies, which make sophisticated electronics, software, and pharmaceuticals. Up and the middle rungs are all the other nations, manufacg everything from steel to autos to memory chips.

ewed in this way, economic development is simple: yone tries to climb to the next rung. This works well if opmost countries can create new industries and products. invention allows older industries to move overseas fresh jobs are generated at home. But if innovation at the highest rung—well, that's bad news for Ameriwho must compete with lower-wage workers elsewhere. day, many are worried that the U.S. has reached the top e ladder and run out of rungs. A growing number of tech and other white-collar jobs are moving to India, Chind other places. At the same time, there's nothing readpparent to replace those exported jobs. What's more, the countries snatching jobs are producing large numbers of college graduates for the first time. The fear is that the U.S. educated class will be ground down by globalization, just as blue-collar workers were in the 1970s and '80s.

It's a scenario that shouldn't be dismissed out of hand—but it's not likely to happen. The U.S. still has a distinct competitive advantage in innovation. If there's any country well-suited to find a new rung for the economic ladder, it's America. Outside of tech, the labor market for educated workers still seems fairly decent, given the stage of the business cycle.

Despite anecdotes of well-paying jobs being sucked overseas, there's little evidence that educated workers, overall, are worse off than they were after the last recession. The average unemployment rate for college-educated workers 25 years and older for the 12 months ended in July was 3.0%. That's lower than the 3.2% for 1992, the year after the last recession.

Some economists have argued that this low unemployment rate stems from educated Americans pulling out of the labor force. Declining labor-force participation over the past year, though, is part of a long-term trend—it fell during the boom of the 1990s as well.

Moreover, the number of jobs held by college-educated workers 25 years and older has risen by 2.2% over the past ▶

YES big, and often disquieting, changes ahead for many. It means the career you studied for—and spent oodles of tuition money on—in college probably won't sustain you for your working life. Someone in India or China will be able to do it far more cheaply.

Another reason for the speed and size of this shift is the nature of service work, especially in our Internet world. Manufacturers must spend years and billions of dollars erecting plants overseas and setting up distribution chains for supply and shipments before moving work offshore. But service jobs need much less infrastructure. Many need only a desk, computer, and Net access.

To be sure, much of today's job jitters are rooted in this rudderless economy. But a structural change is also afoot that could result in a worsening job picture 10 or 15 years down the road. Overall, the global economy will do much better, but the U.S. workforce may face frequent career changes and downward pressures on wages through every part of the economy subject to competition from foreign labor. And that's just as baby boomers will be counting on younger workers to pay a lot of money into the Social Security fund.

What can be done now to prevent such a dreary outcome? There are no quick or easy fixes. Legislation blocking jobs from moving overseas would amount to 1930s-style protectionism. "It would be foolish to stop companies from outsourcing," says Robert B. Reich, mer Labor Secretary under Presi Bill Clinton. "It would make our panies less competitive."

Some in Congress suggest tax cr for companies who keep jobs in U.S. The risk there is that compa will extort bigger breaks—even fo sitions they never plan to move.

Instead, more attention shoul paid to educating the U.S. workf America is on the cutting edge of information and technology econ But others are catching up. India China award more natural science engineering degrees than we do.

The only way the U.S. will keep rung ahead of the rest of the wor to ensure that we have a broadly cated workforce that keeps learn At the corporate level, training grams would help current emplo move up to better positions. And government should overhaul jobless benefits to allow placed workers the time and money to enter new career

Optimists argue that the U.S. will keep its innova lead because it has invented new products before. But underestimates the risk of being overtaken as skill and cation levels rise elsewhere. Unless we focus on maintai a better-educated workforce, that risk will only rise.

Business Outlook Editor Madigan still believes in trade.

LOSING OUR EDGE?

Estimated number of high-skilled U.S. jobs moving offshore*

	2005	2015
LIFE SCIENCES	3,700	37,000
ART, DESIGN	6,000	30,000
LEGAL	14,000	75,000
SALES	29,000	227,000
ARCHITECTURE	32,000	184,000
MANAGEMENT	37,000	288,000
BUSINESS OPERATIONS	61,000	348,000
COMPUTER	109,000	473,000
OFFICE SUPPORT	295,000	1,700,000
TOTAL	588,000	3,300,000

*To low-wage countries such as India, China, Mexico, and the Philippines

Data: Forrester Research

NO year, compared with a 0.4% gain for the less-educated. The jobless rate for college-educated workers has been around 3% since the end of 2001, while the unemployment rate for other workers has increased by half a percentage point, to 5.7%. Wage growth has also been stronger for better jobs. Over the past year, median earnings for managers and professionals are up by 2.8%. Blue-collar and service workers showed no gain.

True, there is pressure on educated workers in the tech sector—but that's coming off a boom. For example, jobs in software and computer-systems design have fallen by 1.6% over the past year but are still up by 70% since 1995, vs. a 7% gain for all private-sector jobs. "I think people are overreacting a little bit," says Steven P. Jobs, CEO of Apple Computer Inc., since big chunks of the tech labor market—including the most innovative parts—are not going to move overseas.

Still, history does offer cause for worry. There was a period, from 1973 to 1985, when technological change contributed almost nothing to growth, according to government data. Not coincidentally, that was also the same stretch when U.S. manufacturing became vulnerable to foreign competitors.

That's why the American economy needs a boost from innovation if it is to continue creating the next generation of leading-edge industries and new high-paying jobs. By its nature, technology leaps are unpredictable and risky—yet that's where the U.S. shines. It has the the biggest economy on earth, enabling America to make technological bets that w crush other nations. The U.S. has by far the best-develope nancial markets in the world, including venture-capital high-yield bond markets for financing new businesses.

And for the foreseeable future, the U.S. still has the best ucated workforce among the m economies, a plus for invention. latest figures from the Organiza for Economic Cooperation & Deve ment show that 30% of Americ aged 25 to 34 have a college deg compared with 24% for Japan and for Germany. That's essential: Bet educated workers can better cope w rapid change, adjust on the fly, imagine and develop fresh prod and strategies.

Where will the next big innova come from? It could be telecom, biotech, or energy. Nobody knows. body knew in 1994, either, when wage growth was still slow, un ployment was above 6%, and the Netscape Communicati Corp. initial public offering, which marked the start of the ternet Revolution, was a year away.

The biggest danger to U.S. workers isn't overseas com tition. It's that we worry too much about other countr climbing up the ladder and not enough about finding the r higher rung for ourselves.

Chief Economist Mandel writes about innovation and nomic growth from New York.

A DEGREE STILL PAYS OFF

Job growth for educated adults is strong, and their unemployment rate is stable

	ONE-YEAR EMPLOYMENT GROWTH*	ONE-YEAR CHANGE IN UNEMPLOYMENT RATE*
COLLEGE GRADUATE	2.2%	0.2%
SOME COLLEGE	0.7	0.5
HIGH SCHOOL GRADUATE	0.6	0.3
LESS THAN HIGH SCHOOL	–1.3	0.6

*Twelve-month average ending July, 2003, compared with same period ending July, 2002, for workers 25 and over

Data: Bureau of Labor Statistics

IGRATION

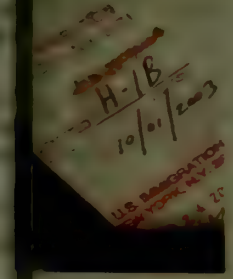
)O MANY SAS FOR CHIES?

workers gripe that lax s may cost them their jobs

)b Simoni has been fuming ever since Toshiba America Inc. replaced him last year with a foreign worker. ni recently found a short-term gig, e wants Congress to do something the H1B visa program that allows anies to bring in skilled foreign ers. The 39-year-old software en- r says he lost his job to such a n, in his case an Indian. Toshiba the outsourcing of jobs "enables us more efficient." But to add insult jury, says Simoni, Toshiba asked o train his replacement: "I never ht this could happen in my field."

battle is brewing over foreign pro- nals in America. On one side are e like Simoni, who say visas creat- r specialized workers such as the nd the L1—granted to foreign em- es transferred to U.S. operations— eing used to bring in rank-and-fil- n the cheap. On the other side are nationals and such groups as the rican Electronics Assn. in Wash- n. They argue that strangling the program could undermine U.S. etitiveness and prompt American oyers to send more jobs overseas. AEA President William T. Archey: still want to have access to the talent."

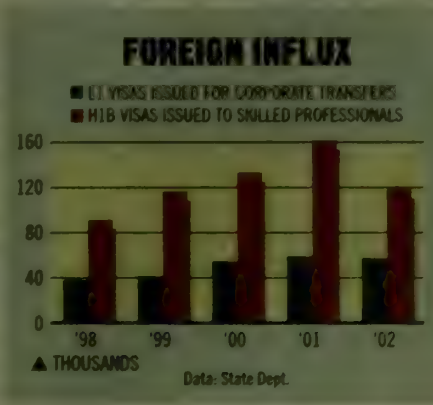
sing joblessness has made visas a utton issue. There are an estimated 00 holders of H1B and L1 visas in J.S., and critics say the number may oser to 1 million. In the past two hs, Congress has introduced four aimed at reforming the visa system. proposed changes range from im- g new limits on existing programs apping them altogether. While some e bills are too draconian to pass, esentative Donald A. Manzullo (R- Ill.), who held a hearing in June on the loss of white-collar jobs, says some reform is "going to happen."



SIMONI: Laid off at Toshiba America after training his Indian replacement

The L1 is generating the most controversy. Instituted in 1970, the L1 has no numerical cap, unlike the H1B. Since 1998, the number of L1 holders has surged 58%, to 58,000 last year.

Critics say the visa has become the preferred tool to replace well-paid Americans with lower-wage foreigners. Partly, that's because the rules governing the L1 are far less restrictive than those for the H1B. While the H1B is filed for individuals, companies can file L1 petitions on behalf of dozens of workers at once. This, say critics, makes it hard for authorities to scrutinize each application. And unlike H1B holders, workers with L1 visas need not be paid "prevailing wages," nor must employers attest that attempts have been made to recruit a U.S. worker for the post.



So how could the visa program be reformed? Although legislation is unlikely to be passed until next year, a bill proposed by Representative Rosa L. DeLauro (D-Conn.) is starting to gain support from lawmakers, activists, and immigration experts. It would impose an annual cap of 35,000 L1 visas, ban the filing of several applications at once, and require companies to pay prevailing U.S. wages. "I believe the situation is reaching crisis proportions," says DeLauro. "We have every opportunity to do something about the L1."

As for the H1B, the quota is set to fall on Oct. 1 from 195,000 to 65,000. Congress had temporarily raised the quota in 2000 under pressure from the tech industry, which was trying to staff up during the Internet boom. The change should placate many critics.

Yet the H1B battle is far from over. Critics say the government needs to do a better job of enforcing existing rules, especially the requirement that companies pay prevailing wages. They also say people applying for visa extensions should be counted against the cap. Owing to peculiarities of the immigration system, only 40% of the 200,000 H1B visas approved last year counted.

But tech-industry groups in favor of the visas are not backing down. Some argue that the government should retain the current quota of 195,000 and not tinker with the program. "If there are more restrictions, then we'll see a lot more offshoring," says Kiran Karnik, president of the National Association of Software & Service Cos., an Indian tech trade group. Either way, Simoni figures his future in software looks grim. He's making plans to leave tech and become a teacher.

By Spencer E. Ante in New York, with Paul Magnusson in Washington

An Indian tech exec counters: "If there are more restrictions [on granting visas], then we'll see a lot more offshoring"

COMPETITION CZAR: *Monti calls Windows' abuses "still ongoing"*

LITIGATION

THE EU VS. MICROSOFT: A RUGGED ENDGAME

At stake is Microsoft's strategy to rule online media

The one principle Microsoft Corp. Chairman William H. Gates III will defend to the end is his company's right to have complete control over the design of its products. Once again, that is being challenged. On Aug. 6, the European Commission's competition czar Mario Monti sent Microsoft a third and final "statement of objections," giving the company one last chance to respond to allegations that it is illegally leveraging its Windows operating system monopoly to gain unfair advantage in the server and audiovisual software markets. To bolster his case, Monti has gathered more evidence from consumers, suppliers, and rivals to show "abuses are still ongoing."

The end of Microsoft's four-year-old case is near, and Monti is digging in for a fight. In a press statement, he laid out potential remedies and revived the key policy issue facing global software: to what extent Microsoft can freely bundle new technologies into its monopoly operating system. While U.S. regulators have allowed Microsoft to do that, rivals see Monti as their last best hope to constrain the giant. Monti's statement left them ecstatic. "The Commission's case has been really nailed down," says Thomas Vinje, a lawyer for the Computer & Communications Industry Assn., a trade group of Microsoft's rivals.

But will EU sanctions be more worrisome to Microsoft than U.S. penalties? Monti's proposal that Microsoft be forced either to rip the media player out of Windows or to bundle in rival products such as RealNetworks' media player could be most disquieting. Microsoft declined to discuss Monti's proposals. But the company has consistently balked at any remedy that dictates what it may and may not put inside Windows. At a meeting with analysts and large shareholders in July, Microsoft CEO Steven A. Ballmer said some matters weren't negotiable. "We will go through a litigation process when we need to," he said.

That would likely happen if Monti tries to force Microsoft to put out a version of Windows without its media player. The player is a key part of Microsoft's strategy to rule the growing online media business. Record companies and movie studios are desperate to find a way to stop consumers from illegally copying music and movies. Microsoft software helps control access to digital material, giving providers control over how their products are used. If the Windows Media Player—which includes antipiracy technology—becomes the de to standard, studios record companies will little choice but to Microsoft's software.

But Monti's alternati including RealNetw player or other rivals in Windows—would pose big difficulties Microsoft. The prece would turn Windows what lawyers call "ar sential facility": tantam to public property. T Microsoft might be requ to add to Windows proc made by rivals who a that they are disadvant by Microsoft's mono Microsoft is fighting a similar legal r by Sun Microsystems Inc. to includ Java technology inside Windows.

Bundling isn't the only issue still fore European officials. To redress plaints that Microsoft leveraged its dows monopoly to gain an ur advantage in the server-software r ket, Monti is also proposing to force company to disclose proprietary techn information. The idea is to give ri such as Sun information that would a their products to connect more se lessly with Windows PCs and serv Microsoft might be willing to give gro on this issue since it agreed to a sim provision in a settlement reached U.S. regulators.

Lastly, the commission can push f fine of up to 10% of Microsoft's ann revenue. That would be $3.2 billion, b on the year ended June 30. But few lieve a fine would climb so high— times what European regulators h ever levied in an antitrust case.

Microsoft has two months to re and it will clearly work to settle. Bar that, it is likely to appeal a negative ing to the Court of First Instance the EC in Luxembourg. That proc could take up to five years—but hav battled this far, Gates won't back do

By Jay Greene in Seattle and A Reinhardt in Paris, with Mike Franc New York

JUDGMENT DAY IS COMING

Penalties European trustbusters might impose on Microsoft:

UNBUNDLING

Microsoft may be forced to remove Media Player from Windows or add rival players. That would weaken its power to set the standard for streaming media.

DISCLOSURE

The EU may push Microsoft to reveal details of how it links Windows PCs and servers. That would make it easier for rivals to work within Windows networks.

FINES

The EC could fine Microsoft 10% of yearly revenues, or about $3. billion. But it's never fined a monopolist more than $75 million before.

COMMENTARY

By Peter Coy

BETTING ON TERROR: PR DISASTER, INTRIGUING IDEA

uicide bombers kill 25 people in Saudi Arabia in May. A car bombing in early August in Indonesia kills at least 10 and injures . Where will terror strike next? e Pentagon's Defense Advanced search Projects Agency hoped to her fresh insights starting in Octo- by launching a small-stakes bet- g parlor for speculation on geopolit- events. The idea was to use rket forces to develop an expert sensus forecast on war- and ter- -related topics. But no sooner was experimental $1 million program olicized than it was killed on July And within days, DARPA's Informa- n Awareness Office chief, John M. ndexter, resigned. Critics said it s immoral for Americans to run a l to bet on death and destruction oad.

The debate over the so-called Poli- Analysis Market has been loud, there have been few answers to ic questions: How was it supposed work? And if it did work, would it ve accomplished something useful? closer look reveals a concept that's per and more interesting than ei- r critics or backers have said.

The plan went through several re- ions, including one in which the ntagon would have allowed betting the first 1,000 members of the blic who applied. But the most ac- table version would have limited tting to invited experts from gov- ment, academia, and industry. ey would have bet on events, ini- lly in the Middle East only, such as ether the U.S. would pull its ops out of Saudi Arabia. Bets on assassinations—the most controversial ture of the experiment—could ve been banned.

To prevent profiteering on bad ws, the wagers would have been pt small. The maximum gain from y trade: $100. DARPA figured the rill of being right would enough to lure bettors. ch new wager would ange the consensus, just odds change at the horse ck as people bet. The re- lt: a constantly evolving llective forecast.

The Policy Analysis Mar- t would have been more comprehensive—and thus more useful—than other online betting parlors. Forums such as Dublin-based TradeSports.com, which takes wagers on sports and current events, handle only bets where there's enough interest to keep the action lively. But thanks to a clever design by George Mason University economist Robin Hanson, the Policy Analysis Market could have taken action on literally millions of possible scenarios. That's because the Pentagon would have posted the original odds on each possible bet, giving people an opportunity to make money off the feds by making better guesses.

POINDEXTER

By giving odds to well-informed bettors, the Pentagon would lose money on average. But with bets limited to $100, it would have been a small price to pay for a snapshot of expert opinion. No one argued that the $1 million spent to launch the Policy Analysis Market could supplant conventional information-gathering and spying.

But its forecasts might have become closely tracked—not only by the Pentagon and the CIA but by multinationals on the lookout for news. After all, other current-events betting pools have worked well. Over the past four Presidential elections, Iowa Electronic Markets has forecasted outcomes better than polls.

Allowing geopolitical experts to wager on terror-related scenarios would have given the Pentagon a unique mechanism to predict danger–and avert it

THE AFTERMATH OF A SUICIDE CAR BOMBING IN RIYADH, SAUDI ARABIA

Could businesses have used the Policy Analysis Market to hedge against events, the way airlines use energy futures to hedge fuel costs? No, because the money was too small. Even if a business successfully wagered that terror would increase in a country where it had operations, its gross winnings would be no more than a few thousand dollars—not enough to offset its losses.

Yale University economist Robert J. Shiller calls the Policy Analysis Market blowup a "PR fiasco" for efforts to launch new markets. That's a shame, because a properly launched project could have made us smarter —and maybe even saved lives.

Coy is Economics Editor.

TOURISM

DOG DAYS' JOURNEY INTO NIGHT

Rain, job jitters... Americans are forgoing vacations in droves

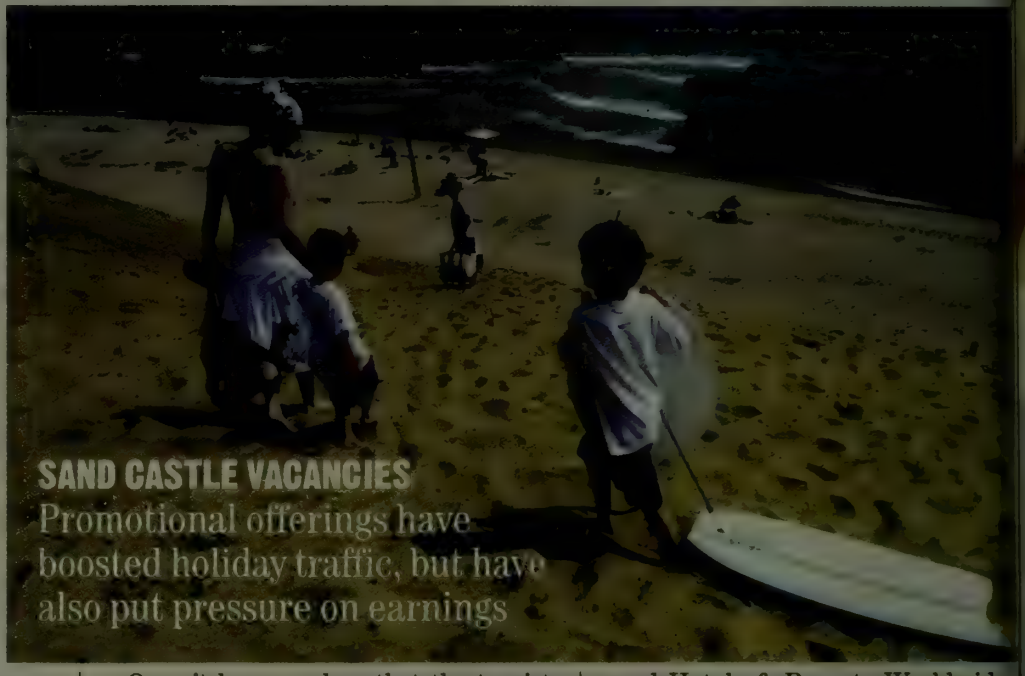
In 33 years as the proprietor of the Trade Winds Inn in Craigville Beach, Mass. on Cape Cod, Alan Isenstadt has never seen a travel season like this one. This time of year, the Massachusetts summer playground should be hopping. Instead, hotels have been slashing rates by up to 20%. Restaurants are pushing two-for-one specials. And in late July, Isenstadt spotted a sign advertising a vacation home in nearby Hyannis for the last two weeks of August. Normally, such places are gone by early spring, he says, adding: "I've never seen a sign like that."

It's a sign of the times. From Cape Cod to California, the U.S. tourist industry is having a lousy summer. Rainy weather early in the season, rising unemployment, new threats of terrorist attacks, and high gas prices—all are prompting many Americans to stay home this year. "It's a challenge to get those leisure travelers traveling," says Bjorn Hanson, head of PricewaterhouseCoopers' hospitality practice.

Hoping to prod tourists from their funk, hotels, theme parks, and car rental companies are scrambling to offer up lavish discounts. That has helped boost traffic, but the promotions are putting pressure on earnings. Already, companies ranging from Hilton Hotels Corp. to Cendant Corp. have reported weak second-quarter profits. And while a surge in August bookings has the industry hopeful for a better third quarter, it's not clear that the hike will be enough to offset a weak June and July.

As recently as May, the industry predicted sunny skies ahead. The war in Iraq was over, stocks were recovering, and consumer confidence was up. But as the ranks of the unemployed swelled, Americans seemed only to swap war anxieties for job insecurities. Nature didn't help. Weeks of unseasonably cool and wet weather from the Midwest to the Eastern Seaboard and scorching heat across the West prompted huge numbers of people to delay or cancel their vacations.

The result: In a June survey, consumer advisers Debt Relief Clearinghouse found that 54% of adults weren't planning a vacation this year, up from 49% last year. In the Northeast, where the weather was particularly abysmal and job cuts widespread, fully 68% said they would pass.



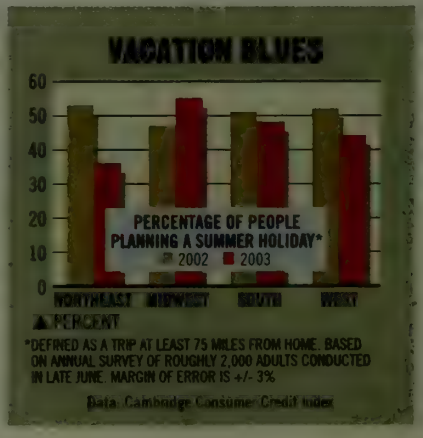
SAND CASTLE VACANCIES Promotional offerings have boosted holiday traffic, but have also put pressure on earnings

Once it became clear that the tourists weren't coming back as expected, travel purveyors began marking down prices. At Disney World, seven-night packages now go for the price of four. Aspen (Colo.)'s tony Little Nell Hotel is offering $195 rooms in July and August, half the normal rate. And Princess Cruises is promoting $99 companion fares on seven-day cruises this fall in the Caribbean and South Pacific.

Those discounts may have increased traffic, but the travel industry is paying for them. Margins at Disney's U.S. theme parks have fallen to 20%, down from 25% last year. Cruise-fleet operator Carnival Corp. says its net yields declined 8.6% in the quarter because of lower ticket prices and occupancy. dant says operating income at its rental car unit slid, too.

Hotels are bearing much of brunt—especially since Americans waiting until the last moment to b That means hotels can't charge top lar. The average room rate at prope owned by Hilton is down 3.9% this over last, to an average of $146 a n Largely as a result, Hilton's sec quarter profits slid 29% over last to $54 million. Operating income at dant's lodging unit, which includes Howard Johnson, Ramada, and T elodge chains, also slid 13%, to million, in the second quarter.

Will August save the season? wood Hotels & Resorts Worldwide says bookings rose in July. Discount rier AirTran Airways says its July t fic numbers were an all-time high; airline describes bookings in Augus "incredible," with sales way up to v tion sites such as Florida and Las gas. July attendance rose 3% at neyland and 8% at Disney World. execs are uncharacteristically restrai in their outlook. dramatic rise in near-term is unlike warns Disney Pr dent and Chief Op ating Officer Rob A. Iger. That fat American wanderl Maybe next year.



By Michael Ar in Chicago, Christopher Paln in Los Angeles, Fe Arner in Boston, bureau reports

HARP.

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COMMENTARY

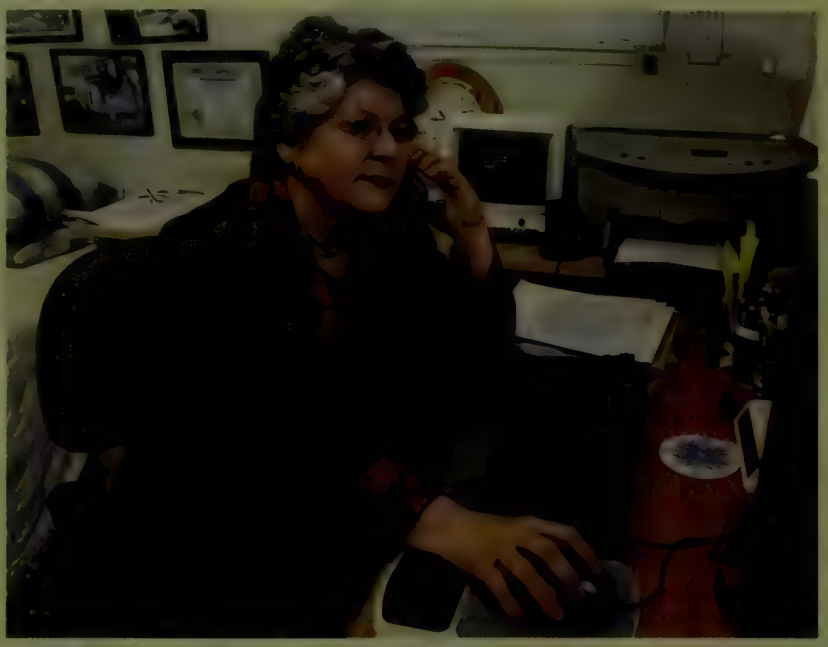
By Nanette Byrnes

PENSIONS THAT DISCRIMINATE AGAINST OLDER WORKERS

Kathi Cooper is something of a rarity in America these days. She has spent her entire career with a single company. For the past 24 years, Cooper has thrived at IBM, first in finance and planning and now working in internal controls. "I absolutely adore that company," she says.

Yet that didn't stop Cooper, 53, from taking IBM to court over changes it made to its traditional defined-benefit pension fund in 1995 and '99. She and thousands of other employees had tallied up their payouts under the newest plan, a so-called cash balance plan, and compared them with the old one. Younger workers with shorter tenure at Big Blue would make out better under the new plan, but to veterans like Cooper, the math didn't look right. And on July 31, Federal Judge G. Patrick Murphy of the Southern District of Illinois agreed. He concluded that the plan was indeed unfair, and in fact illegal.

Murphy's ruling, of course, is by no means the last word. IBM will appeal. At the same time, other courts in other cases have ruled in favor of companies with similar types of plans. But Murphy's decision points up something systemic and troubling about today's pension system. There is a basic mismatch between pension law and the way business really works. It has been decades since the dream of a worker was to stay put in one company for life. That's one reason why IBM and a legion of other big companies in recent years have replaced traditional pension plans with those that don't penalize workers who change jobs.



SUING BIG BLUE IBM redefined Cooper's defined-benefit plan

With those plans increasingly under attack by older employees, though, it's becoming clear that a company's best interests are not always going to intersect with those of all its workers. That's why Congress needs to step up with clear legislation that would reform federal pension laws for the first time in a generation. Until then, lawsuits and divergent court decisions will become the norm, leaving both workers and companies in a state of pension limbo. Worse, facing higher costs, companies threaten they might abandon cash balance pension plans altogether.

Congress will have its hands full. The issue is highly technical and politically charged, with huge stakes for two opposing groups pols can ill afford to antagonize: baby boomers nearing retirement and big corporations. Senate Finance Committee Chairman Charles E. Grassley says he is studying the court decisions, but is unlikely to act until the IBM appeal and that of another case against Xerox Corp. are concluded. "We'll need to look at these decisions with an eye toward protecting older workers and ensuring that there are sufficient incentives for employers to maintain defined benefit plans," says Grassley.

So what would an ideal pension plan for workers in 2003 look like? It would be one that employers fund and at least partially guarantee, backed by the government. That would echo how old-style defined pension benefit plans work. But it would also incorporate the portability and simplicity that more modern cash balance plans aim for.

There's no reason why that can't be accomplished. But a lot of work remains to be done to iron out workable reforms. According to Murphy's ruling, today's cash balance plans break one of the key covenants of guaranteed pension plans: that they will never discriminate against older workers. Finding a way to structure them so they don't should be Congress's top priority in the debate.

Solving the problem is vital because hundreds of other employers have switched to IBM-style plans. According to benefit consultants Hewitt

PENSION LOTTO?

A worker who takes a $30,000 job at 22, works until age 60, and gets yearly raises of 4% would receive retirement benefits of widely varying values depending on the type of plan:*

		TOTAL BENEFIT RECEIVED IF WORKER STAYS AT COMPANY	TOTAL BENEFIT RECEIVED IF WORKER CHANGES JOB 3 TIMES
DEFINED BENEFIT PLAN	Current value of promised payments throughout retirement	$565,031	$354,476
401(K) AND PROFIT SHARING	Company-matched contributions plus investment returns	$447,144	$447,144
CASH BALANCE	Company contribution with interest	$422,139	$561,263

*Includes a series of assumptions based on typical existing plans

Data: Watson Wyatt Worldwide

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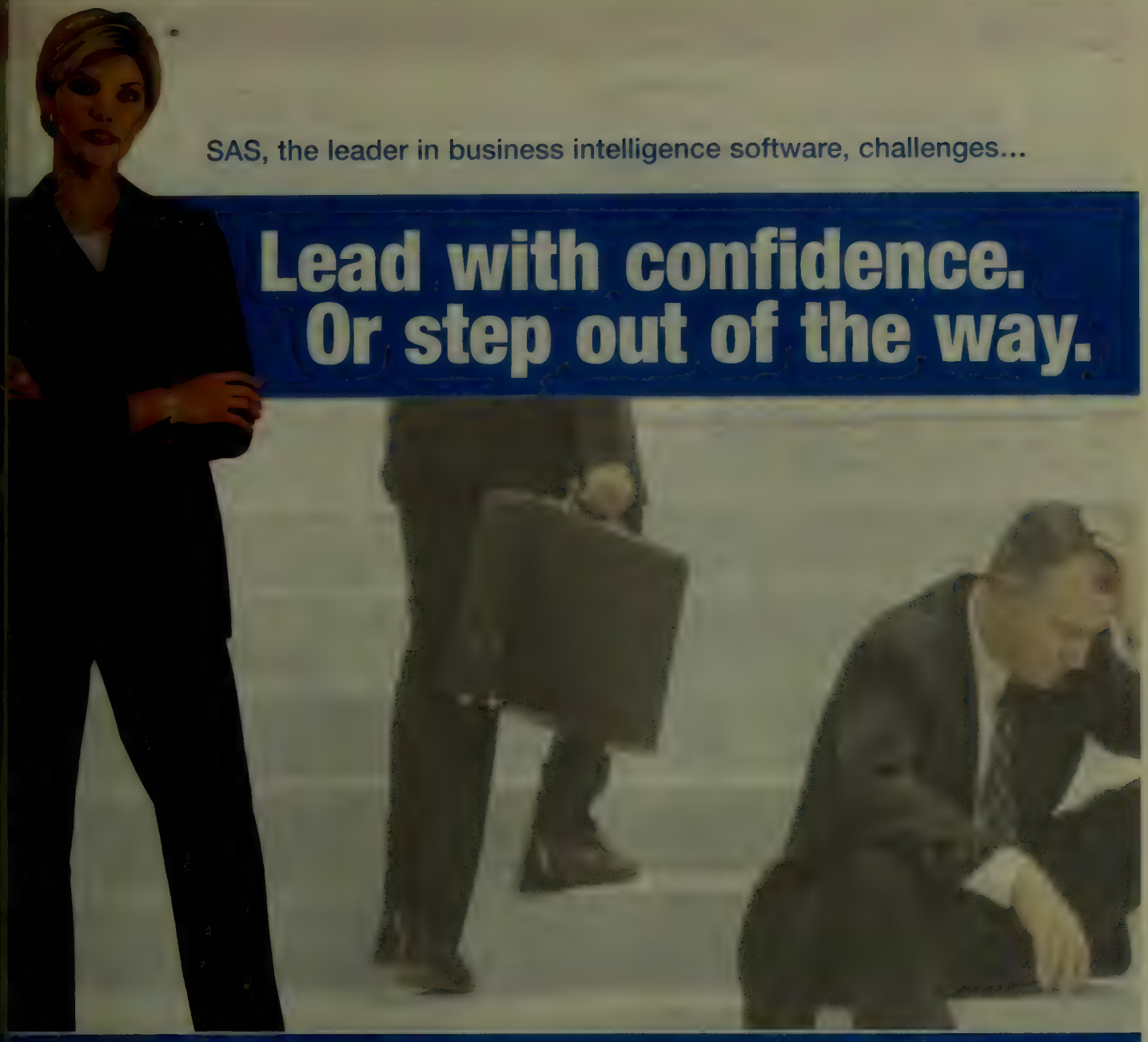

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Associates, 30% of large employers have cash balance plans today. All told, 14% of U.S. employees are covered by them at employers ranging from Federated Department Stores and Verizon to Colgate-Palmolive and even Harvard University.

Without a solution, some worry that many companies will just suspend their plans. "These rulings increase significantly the cost of sponsoring pension plans and put the future of such plans in serious jeopardy," says Patricia M. Nazemetz, vice-president of human resources at Xerox. The day after the IBM decision, a court ruled that Xerox owes $300 million related to its own cash balance plan in a suit that revolved around the calculation of interest for departing workers, a different issue from the IBM case.

The crisis in cash balance plans also comes at a time when the entire retirement system is struggling. Social Security funding is an ever-present worry and a combination of low interest rates and poor stock market returns has left old-time corporate pension funds with too little cash to meet their coming obligations. Burdened by a number of recent plan failures—including Enron's cash balance plan—the federal Pension Benefit Guaranty Corp., which insures pension funds, is struggling. If companies were to abandon cash balance plans, which make up a good section of the PBGC's revenue base, that could spell further trouble for the agency's financial health.

The IRS is in the process of writing regulations for cash balance plans and may publish them before the end of this year. But employee activists argue that Murphy's decision proves existing law doesn't cover these plans and a new law is needed. "We need to create plans anew, authorized by Congress," says Karen Friedman, Director of Policy Strategies at the Pension Rights Center, "not created in the dark of the night and that don't fit the statutory framework of the pension law." Pension plans that are fair to both long-term older workers and more mobile younger ones should be the goal.

With Howard Gleckman and Amy Borrus in Washington

FAST FOOD

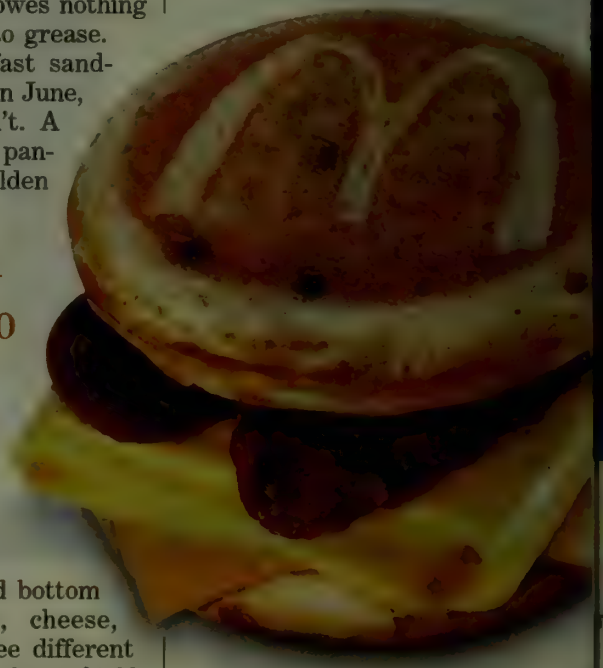
SAVING MICKEY D'S BACON

Salads are helping–but so are the gut-busting McGriddles

For troubled McDonald's Corp., the second quarter delivered good news. Sales rose a strong 4.9%, as the company seemed to snap out of its long torpor. And most pundits credited the burger chain with a sort of death-bed conversion to more healthful food: Much of the gain came from the strong performance of a popular new line of salads. But there was another side to the turnaround—one that owes nothing to greens and everything to grease.

The McGriddles breakfast sandwich, launched nationwide in June, is everything a salad isn't. A couple of syrup-drenched pancakes, stamped with a Golden Arches "M", act as top and bottom "buns" holding in eggs, cheese, sausage, and bacon in three different combinations starting at about $1.89. The gut-busting mix—which comes to 550 calories, 33 grams of fat, and 260 milligrams of cholesterol—has taken off like wildfire, sending McDonald's morning sales soaring.

ApeChild.com rates the combo four bananas out of five



Moreover, the throwback to a pre-Pilates world has sparked a cult-like fascination. Many Web sites that appeal to a younger, hipper demographic have active message postings and forums on McGriddles. ApeChild.com, a Web site "for the primate in all of us," gave McGriddles a four-banana rating and proclaimed it a hangover helper. X-Entertainment.com's review noted that, with all the grease, McGriddles' wrappers become "translucently oily, which is a great way for illiterate people to tell" which of the McGriddles variations is inside. Even Howard Stern couldn sist delving into McGriddles o morning radio show. The shock claimed he would love to be the Griddles spokesperson and went do a commercial spoof on the "juic licious pancake, 75,000 of the best ries you'll ever taste."

Not all the reviews are positiv course. McGriddles got put in the of Shame by eDiets.com, which gested that the syrupy M on top for murder. Various groups wer ready targeting McDonald's bur fries, and other fast-food for their tribution to obesity. Even McDo ads promote McGriddles as "Biz but yummy." The company says, ever, that the rollout was a huge h won't provide sales numbers, but Frick, director of menu manageme McDonald's headquarters in Oak B Ill., says: "June was the highest b fast sales month for McDonald's i years." McGriddles are now second to the sausage McMuffin with among McDonald's highest-selling br fast items.

Of course, the chain has a histo launching offbeat concoctions with of gusto, then losing interest. Remem the Grilled Chicken Flatbread sandv McDonald's made a point of sayin wouldn't do that with McGriddles the new salads, calling them "pe nent" additions to its menu. Still, s fans aren't taking any chances: Magazine's Web review suggested readers "buy one now, before the elty fades like pork fat dissolvin hand soap and water." Yum.

By Pallavi Gogoi in Chi

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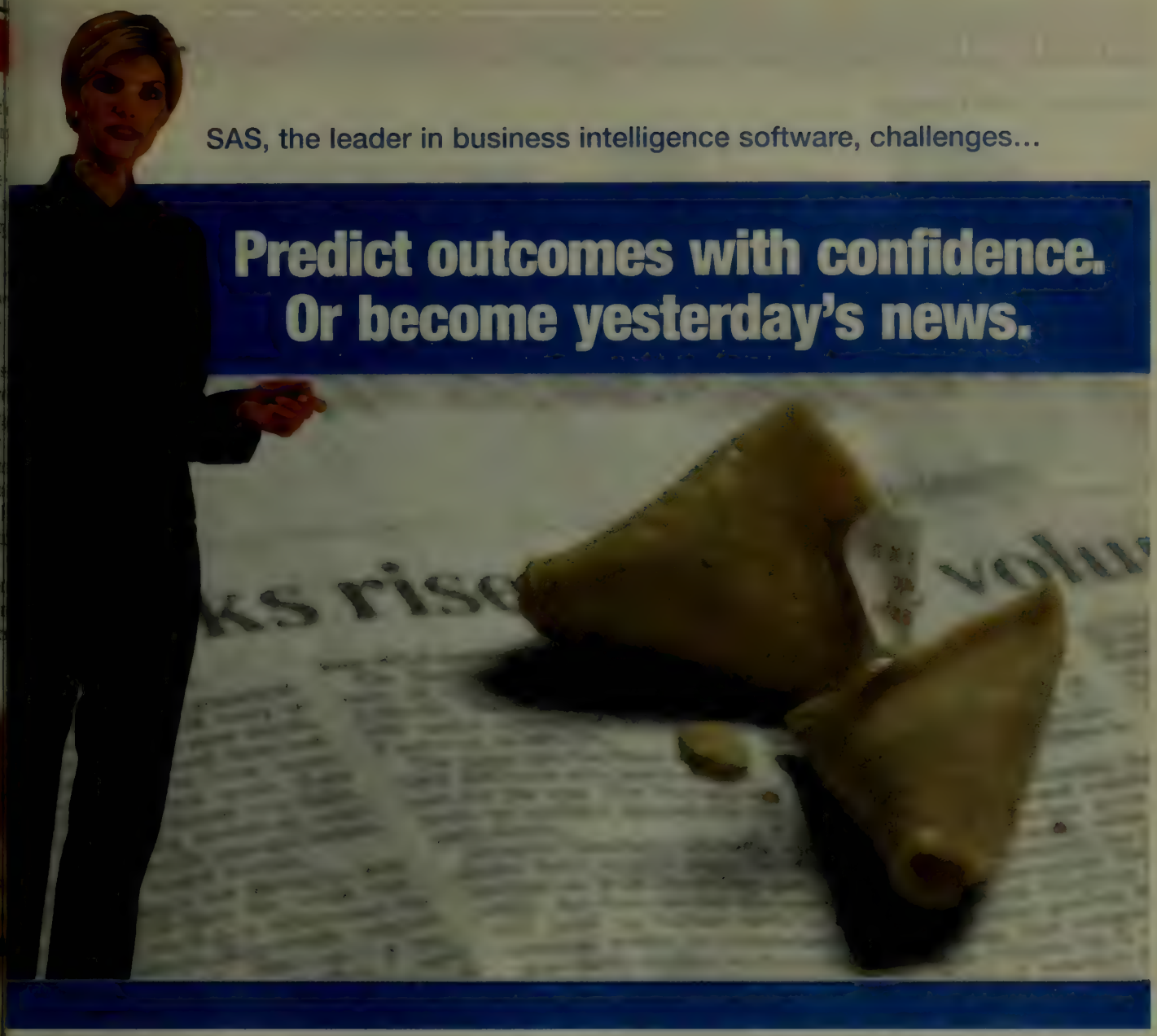

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In Business This Week

EDITED BY ROBIN AJELLO

MERCK WILL WASH ITS HANDS OF MEDCO

MERCK IS FINALLY READY TO complete its divorce from pharmacy-benefits-management outfit Medco Health Solutions. On Aug. 5, the drugmaker announced it would spin off the unit through a share distribution of new Medco stock to existing Merck shareholders on Aug. 19. Medco will pay Merck a $2 billion dividend as part of the deal. The move comes after Merck pulled the plug on a partial initial public offering of Medco because of meager market interest. Investors say Merck is better off without Medco, in part because of an ongoing Justice Dept. probe of the pharmacy-benefits-management industry.

LAWSUIT CITY OVER LINUX

THE MUDSLINGING OVER Linux software is getting worse: On Aug. 4, top Linux distributor Red Hat filed a lawsuit against SCO Group, in which it charged that the Unix software maker has waged an "unfair and deceptive campaign" intended to cast a pall over the fast-growing market for the Linux operating system. Red Hat's action comes after a $3 billion suit filed by SCO last March against IBM, in which SCO accused Big Blue of misappropriating parts of its copyrighted Unix software code for use in the version of Linux that it included in some of its computers. Red Hat says it filed its own case in hopes of expediting SCO's lawsuit against Big Blue, which has been hung up by SCO's unwillingness to let experts examine the disputed code.

TIME TO DRESS UP TOMMY HILFIGER?

COULD TOMMY HILFIGER END up on the auction block? The troubled trendy apparel outfit couldn't have picked a better person to get it ready for sale than David Dyer. He was named president and chief executive on Aug. 4. Dyer, 54, did a masterful job of dressing up Lands' End, and then selling the company to Sears Roebuck last year for a stratospheric $1.9 billion. Still, Dyer will confront some big problems at Hilfiger. The company has lost its allure with the young and urban, which has put pressure on sales and profits. A Hilfiger spokeswoman says the company isn't for sale, but some analysts believe Dyer's appointment belies that message.

THE NASTY THORN IN COSTCO'S SIDE

BLAME IT ON WAL-MART Stores. On Aug. 5, executives at Costco warned that the company's profits will fall below projections, in part because of stiffening competition from Sam's Club, Wal-Mart's wholesale discount chain. Earlier this year, a price war broke out between Sam's and Costco, putting pressure on margins. As a result, Costco, based in Issaquah, Wash., slashed its fourth-quarter profit estimate to 46¢-48¢ a share, down from 54¢-56¢, for the period ending Aug. 31. The company also cut its full-year outlook to $1.48-$1.50 a share, down from $1.56-$1.58. The news sent Costco shares tumbling 22% over the next two days.

NOW, EMC LOOKS A-OK

EMC SAYS IT'S BACK ON TRACK. On Aug. 6, the Hopkinton (Mass.) data-storage giant announced that it expects to record a profit for the rest of the year. The company also said it expects to gene revenue growth in the teens for the second ha 2003, as well as for 2004. Chief Executive Jo Tucci attributed the pos outlook to a slight impr ment in tech spending says its new line of prod including storage devic the low, mid, and high e the market, will help EMC's sales growth. "W expecting the light at the of the tunnel to brighter," he told analys New York.

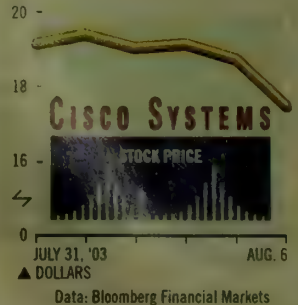
ET CETERA . . .

- Tenet Healthcare agreed to reimburse the government a record $54 lion in overcharges.
- A judge approved the S rities & Exchange Commis $750 million fine against
- SBC Communications to deploy 1,000-plus h speed Wi-Fi connections.

CLOSING BELL

SCOLDING CISCO

Tech investors again want brisk sales growth, even in the battered networking market. On Aug. 5, Cisco Systems announced that quarterly earnings rose 27%, to $982 million, and said sales might grow up to 4% this quarter. Not good enough. Wall Street drove the stock down 8% in the next two days.



Data: Bloomberg Financial Markets

HEADLINER: MARJORIE MAGNER

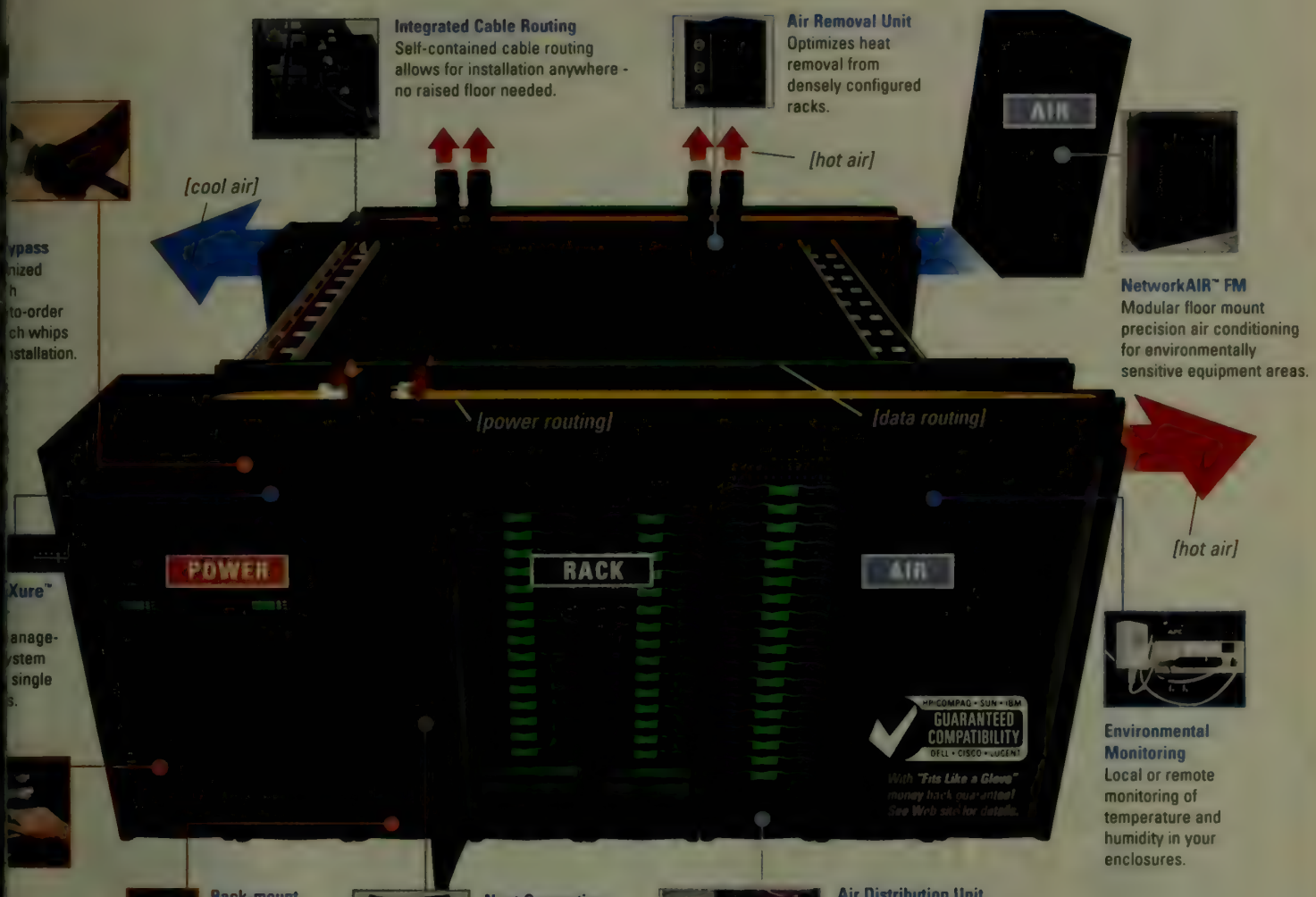
CREDIT-CARD SHOPPER

Already one of the most influential women on Wall Street, Citigroup's Marjorie Magner has jumped up another rung. On Aug. 6, the 54-year-old Brooklyn (N.Y.) native was named head of Citigroup's global consumer bank, overseeing retail banking, credit cards, and consumer finance.

As the outfit's most profitable arm, the consumer bank earned $4.5 billion in profit last year and generated half of Citigroup's total earnings for the first half of 2003. The promotion makes Magner the second woman to be named to a top post at Citi in a yea after Sallie Krawcheck, who runs equity researc and the brokerage ar Magner succeeds Robert Willums who took over president two weeks earlier part of Chairm Sanford Weill's succession pla A 16-year Cit group veteran, Magner has earne high marks for her acumen in acquisitions and consolidation. As the na tion's largest financial i stitution moves forwar on plans to buy up riva banks and bulk up in cr it cards, those skills should come in handy.

Mara Der Hovanes

If they come, you will build it.



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ED BY MIKE McNAMEE

AY MARRIAGE: LAYING WITH POLITICAL FIRE

hen President George W. Bush took a strong stand against gay marriage at a July 30 news conference, there seemed to be no political downside. "Marriage is een a man and a woman," Bush said. "I think we ought dify that one way or the other." Millions of social con- tives applauded. And GOP strategists were gleeful at a e to force Democrats to confront an uncomfortable issue. t opposing gay marriage is the easy part. As gay rights s bubble up in courts and state legislatures, polls reflect nbivalence in the nation that puts both es in a bind. That means Bush may be d to juggle compassion and conservatism tisfy his base without igniting a culture hat alienates the center. And Democrats gay activists must take equal care not to reach. "The American public wants to be nt on this issue, but they don't want to be ed into feeling like they endorse the yle," GOP pollster Edward Goeas says.

hen the Supreme Court overturned a s ban on sodomy in June, polls showed a ing backlash against homosexuality. But corporations are extending benefits to ers of gay employees, and gays are an growing presence in pop culture—witness o network's surprise summer hit, *Queer for the Straight Guy.*

rtainly gay marriage is an issue that won't vay. Massachusetts' highest court could decide any day her a law banning same-sex marriages amounts to dis- nation. A ruling against the state would set off a wave of ar lawsuits across the country. "Gay marriage has de- led on us like a freight train," says Sandy Rios, president ncerned Women for America, a conservative coalition. sh strategists think they can ride that train without en- ering votes in the center. So far, the President has punt- n a constitutional amendment banning gay unions and remains mum on "civil unions"—state laws giving gay couples many of the same rights as married heterosexuals. "Politically he's playing it very well," says Patrick Basham, senior fellow at the libertarian Cato Institute. "He's against gay marriage, which keeps the base with him and helps with turnout, but he also emphasizes that one should be tolerant of that lifestyle, so he doesn't alienate the moderate, suburban female voter."

Vice-President Dick Cheney, who has a lesbian daughter, said of civil unions during the 2000 campaign: "We live in a free society, and freedom means freedom for everybody. I don't think there should necessarily be a federal policy in this area." But the Right is clamoring for action, and the White House has reason to pay attention. An estimated 4 million to 6 million evangelical voters stayed home on Election Day, 2000, and Bush can't risk losing them again in 2004.

COMMITMENT CEREMONY

Conservatives want to go beyond the 1996 Defense of Marriage Act signed by President Bill Clinton, which defined marriage for federal purposes as the union of heterosexuals. The constitutional ban that the Right wants Bush to endorse would even override any state laws that allow civil unions—such as the one Democratic Presidential candidate Howard Dean signed as Vermont's governor. Bush "has to oppose anything that tries to counterfeit marriage," says Genevieve Wood of the conservative Family Research Council.

If Bush goes further than he has and the Democrats can't rein in radical elements, the result could be a polarizing debate. Says Winnie Stachelberg, political director of the gay and lesbian Human Rights Campaign: "If either political party attempts to make a wedge issue out of this, it will backfire." Maybe. But with passions running high and Americans so conflicted, don't count on caution.

By Lorraine Woellert

CAPITAL WRAPUP

E DEMS' SENATE WOES

he Aug. 4 announcement by Sena- Ernest F. "Fritz" Hollings (D-S.C.) t he would not seek a seventh term ldn't have been worse news for De- crats. Senator Jon Corzine (D-N.J.), former Goldman Sachs exec spear- ding efforts to reclaim the Senate, scored some solid recruiting suc- ses, and the Dems' fund-raising is hin striking range of the GOP. So party had figured that it had a d chance of at least maintaining the rent 51-48 split in favor of the Republicans—and might even improve.

But the South may deepen the Democrats' Senate minority in 2005. The party isn't likely to hang on to either Hollings' seat or that of Georgia Senator Zell Miller, who is also retiring. Incumbent John Breaux of Louisiana would be a shoo-in if he runs, but he has put off any announcement. And the Presidential ambitions of Senators John Edwards (N.C.) and Bob Graham (Fla.), both up for reelection, are complicating the outlook. Graham will maintain his seat if he runs, but Edwards' stalling may already have cost him or any Democrat a chance to win North Carolina.

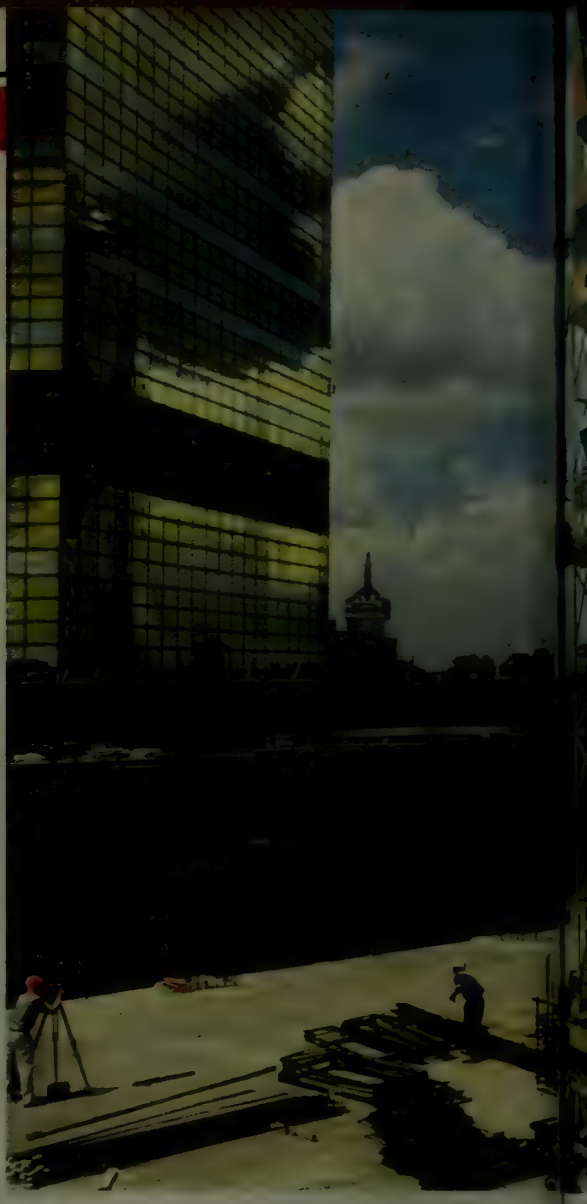
Democrats' Southern woes are offsetting the party's gains in Illinois, where the best likely GOP candidate is taking a pass, and Alaska, where former Governor Tony Knowles is challenging Republican Senator Lisa Murkowski. Corzine will keep up the fund-raising—hosting dinners with former Treasury Secretary Robert E. Rubin. But with the South slipping away, even Corzine's strenuous efforts aren't likely to keep hope alive.

By Alexandra Starr

CHINA

DROWNING IN DOLLARS

It's a problem for China, but is revaluing the yuan a wise move?



For years, Shanghai mortgage broker Linda Liu happily parked most of the money she saved while living in San Diego in U.S. securities. But lately she has been hearing rumors that China will revalue the yuan, which for nine years has been pegged at 8.28 to the dollar. Some analysts figure the yuan could appreciate up to 30%. So, like many other Chinese with offshore holdings, Liu decided to bring her money back home. She sold some U.S. stocks and made a downpayment on a $160,000 apartment in Shanghai's tony Jingan district. "I'd rather have my money in property," says Liu. "Besides, if the yuan is going to be revalued at six to a dollar, you've just made money."

Rational behavior, perhaps. But worrying, as well, for Beijing's financial mandarins. By rushing to swap their dollars for yuan, Chinese investors and savers are demonstrating that the mounting calls in the U.S., Europe, and Japan for Beijing to revalue its currency already are starting to influence financial markets—even though China insists it will maintain the peg. More ominously, as citizens such as Liu—as well as overseas Chinese from Taiwan to Toronto—plow those funds into mainland assets, there are fears the overvalued yuan could fuel a nasty bubble. In Shanghai, prices for luxury flats have risen 62% since 1999, to around $1,400 per square meter.

The quandary is what China should do to stem a bubble. Critics of China's currency regime say the speculation bolsters their argument the yuan should float, or at least be sharply revalued. China is indeed bulging with dollars: Its foreign reserves stand at a stunning $346 billion and are rising fast, fed by export earnings, foreign investment, and the return of $20 to $30 billion in the past six months in funds held offshore or under mattresses, says J.P. Morgan Chase & Co. economist Joan Zheng. Such imbalances could ignite the kind of frenzy and overbuilding of everything from office towers to steel mills that preceded Asia's 1997 crisis.

But boosting the value of the yuan may not be the best way to tame China's capital flows, say a growing number of economists and currency analysts. In fact, it could do more harm than good—not just for China but also for the global economy. Among the hazards on the Chinese side: a big slowdown in the mainland's export machine. That would depress China's need for imported raw materials and machinery. It also w hurt incomes, which would lower nese demand for imported consu goods. On the U.S. side, a higher y would boost U.S. prices for everyth from toys to power tools, and trigg fall-off in Chinese purchases of Treasury securities.

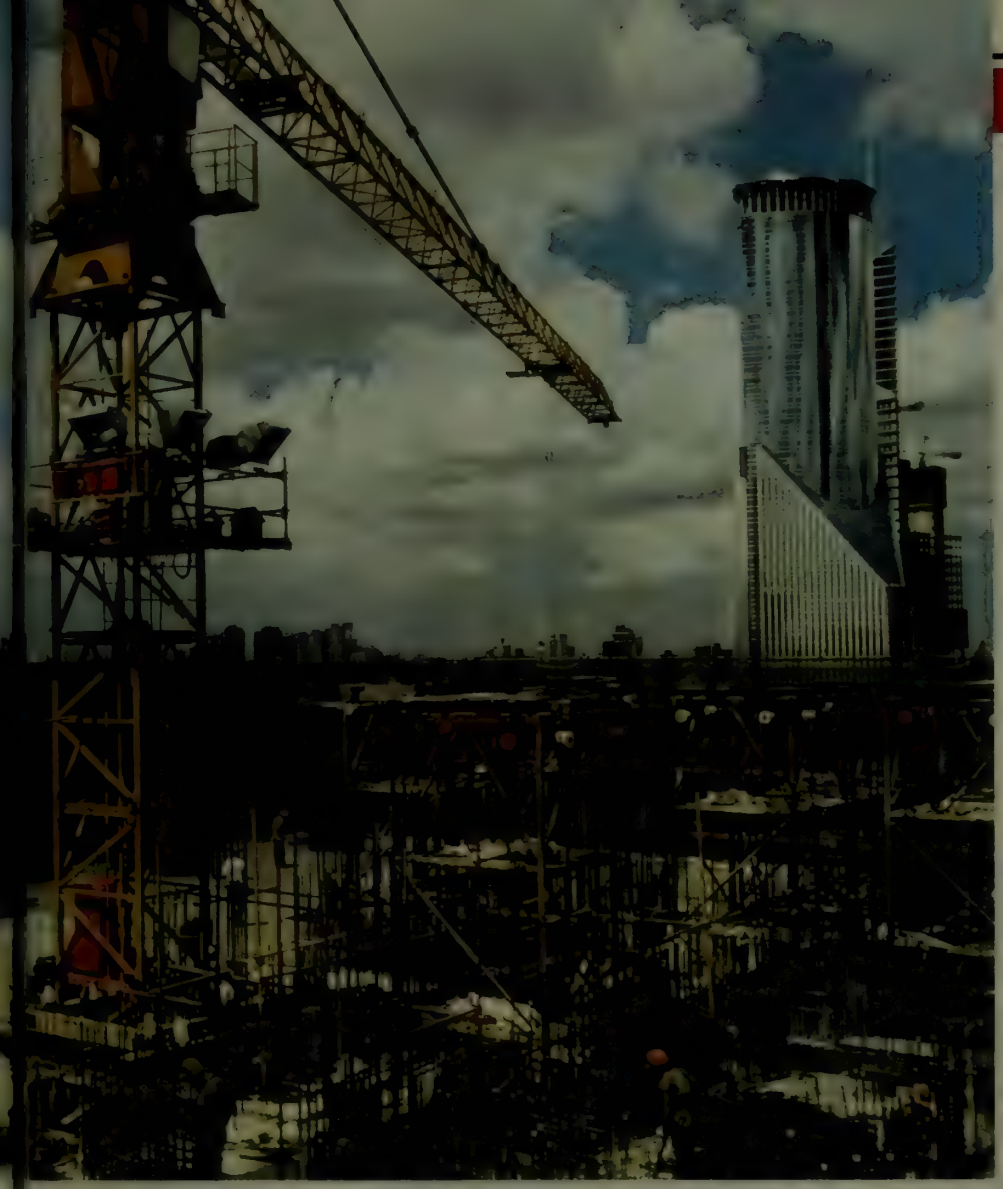
BIG RISKS Revaluing could

The more fundamental risk is breaking the yuan peg would sha faith in China's currency stability, big consequences for the mainland e omy. Stanford University econo Ronald I. McKinnon argues China's lar overhang is so huge that dollar ing in China might feed on itself. Bei

THE HAZARDS OF A STRONGER YUAN

If the yuan strengthens, China's trade surplus with the U.S. would drop. But there are downsides.

- China is a key buyer of Treasuries, keeping interest rates low and financing U.S. deficits. A revaluation would leave China fewer dollars to invest.
- China's imports are growing faster than its exports, producing one of the world's few growth engines. A slowdown in exports would cut China's imports.
- One revaluation would raise expectations of more. An ever-stronger yuan could stifle economic activity and push China back into a deflationary cycle.
- A stronger yuan would raise cost for Chinese manufacturers, driving up U.S. prices for goods such as apparel, shoes, toys, and electronic products.



SHANGHAI HIGH
Work on a Citigroup office is part of a building boom

ts, depress jobs, and import demand

t have to revalue upwards not just but several times—with dire re- for exports and eventually domes- emand and prices. "Once people get lea the yuan will always be higher year, you get intense deflationary ure," McKinnon says. "This is ex- what happened to Japan 10 or 15 ago," when Tokyo strengthened en at U.S. urging.

Beijing gets its currency policy g, it could derail one of today's only conomic growth engines—one that is ng in immense quantities of car , computer chips, and machinery. noney China recycles into the U.S. uying $10 billion in Treasury bonds month, meanwhile, is vital to keep- down interest rates and financing rica's yawning current-account and al budget deficits, which are nearing nbined $1 trillion. With saving rates ping in Japan, Korea, and Taiwan, a is emerging as an even more vital ter of capital.

there a way out of this fix? Econo- say that instead of revaluing, Bei- could stop subsidizing export in- dustries. It also could let foreign companies in China borrow yuan rather than bring in dollars. And it could allow Chinese citizens and financial institutions to buy foreign stocks. Besides reserves held by the central bank, Chinese businesses and households—which sock away 28% of annual income—have amassed $150 billion in dollar accounts in local banks.

Whatever it does, Beijing must keep China's economy moving. Chen Zhao, chief emerging-market strategist at Montreal-based Bank Credit Analyst Research Group, notes that China is emerging from eight years of dropping consumer prices caused by oversupplies of everything from farm goods to TVs. Thanks to rising incomes due in part to the export boom, demand is picking up. But inflation is a meager 0.3% despite lots of fiscal stimulus from Beijing. And while Shanghai housing prices are surging, China's overall property market still hasn't recovered from a bust a decade ago. "A little heat is good right now for China's economy, and the rest of the world should be encouraging it," Chen contends. If the yuan rose 15%, he predicts Chinese deflation will return.

Slower Chinese demand also could hammer world trade. Even though China's politically sensitive trade surplus with the U.S. is rising, China's overall trade surplus has shrunk 70% in six months, to $6.9 billion. That's because imports have surged by 45% in the past year, to $350 billion, and are rising faster than exports. That may seem counterintuitive, since a cheap currency makes imports more expensive. But as China dismantles trade barriers, demand for luxury cars and cell phones is soaring. And to fuel its export machine, China must import electrical components, raw materials, and oil. China's steel imports soared 80% in the first seven months of this year, to 30 million tons. And China's imports of machinery leaped 50%.

Beijing leaders can't ignore signs of overheating, of course. In Shanghai, stories abound of Taiwanese investors buying luxury flats and flipping them at a 15% profit in one week. Real estate is seen as a "one-way bet," says Christopher Cuff, executive director for agency services at Cushman & Wakefield Premas. "Property has to go up, and there's a significant chance the yuan will appreciate." In June, the central bank said it would tighten credit for developers and homebuyers.

Beijing is already trying to soak up excess liquidity. Since late 2002, commercial banks have repatriated $60 billion from the U.S., Morgan Stanley estimates. To head off a lending binge, the government is issuing bonds. But the money supply is still growing at 20%, and China lacks a developed market for trading such paper. Beijing also is mulling a cut in tax rebates for exporters. There's even talk of letting Chinese mutual funds and insurance companies buy Hong Kong stocks, and of making it easier for Chinese companies to make foreign acquisitions.

Expect more shrill cries from Washington for China to revalue the yuan. But Beijing may do well to demur. It could do the global economy a bigger favor by finding a way to ease its dollar glut without choking demand.

By Frederik Balfour in Hong Kong, with Alysha Webb in Shanghai, and Peter Coy and Pete Engardio in New York

COMMENTARY

By Moon Ihlwan

HOW KOREA HAS CHANGED—AND HOW IT HASN'T

When a worker sweeping the garden of Hyundai Group headquarters found Chung Mong Hun's body on an early August morning, he could not believe he had come upon the corpse of one of the nation's most influential tycoons. But for Hyundai Group chief Chung, 54, who had leaped from his office window, death was the only escape from a huge scandal involving $500 million in payments that Hyundai funneled to Pyongyang in exchange for Kim Jong Il's participation in a summit with then-President Kim Dae Jung. Chung admitted in court to violating foreign exchange laws in sending the money to North Korea and using false accounting to cover things up. Ex-President Kim Dae Jung, meanwhile, denies any wrongdoing.

Chung's death underlines how much Korea has changed—and how much it hasn't. The Chung prosecution is the latest clash between an emboldened judiciary and the *chaebol*. Determined to rein in the big companies and end the era of dirty politics, prosecutors have taken on the chairman of Daewoo, the boss of SK Group, and now the remnants of mighty Hyundai. A decade ago, this would have been unthinkable.

A huge change, indeed. Yet Chung's death shows just how dangerously entangled the *chaebol* remain with affairs of state. Seoul relied on a corporate heir to reach Kim Jong Il even though Chung had his own, private agenda of expanding the Hyundai presence in the North. That's astounding—and shows how primitive some aspects of Seoul's North Korean policy are.

It's the stuff of high drama, and it's appropriate that it centers on the Chung clan. Chung Ju Yung, Mong Hun's father, epitomized the nation's miraculous rise from the ashes of war. The elder Chung built an empire based on relentless energy and commercial savvy: He landed a shipbuilding contract, for example, even before he built his shipyard. But he also relied on political connections to support his debt-fueled diversification into cars, ships, computer chips, and department stores. Born in what is now North Korea, the senior Chung also saw the North as the next part of Hyundai's expansion.

Along the way, Hyundai changed with Korea. The sprawling *chaebol* could not sustain all of its divisions. More important, the sons could not maintain the unity their late father long enforced. In 2000, a year before their father died, Chung Mong Hun and his elder brother, Mong Koo, chairman of Hyundai Motor Co., publicly attacked each other over who would take control of the group. The feud coincided with a liquidity crunch at the construction and shipping units—the businesses that bankrolled Hyundai's risky new ventures in the North after the 1997-98 Asian crisis.

The feud triggered a rebirth of sorts. By September, 2000, Hyundai Motor—controlled by the elder brother—formally severed links to the rest of Hyundai. Freed from the debt-besotted *chaebol*, Hyundai Motor emerged as a dynamic, profitable company. Another moneymaking piece of the group, Hyundai Heavy Industries Co., the world's largest shipbuilder, controlled by the sixth brother, Mong Joon, became independent, too: Analysts expect it to turn a big profit this year. "The breakup was a blessing for the country," says Min Sang Kee, a business administration professor at Seoul National University.

Yet in the process, Chung Mong Hun, a shy man who was long his father's favorite, got stuck in another era. To preserve his father's legacy, he poured more than $1 billion into projects in North Korea, even though he knew they would not generate profits for years. The plan brought some benefits, since it ensured support from the government of Kim Dae Jung, who had a "sunshine" policy of reconciliation. "Several Hyundai companies would have collapsed if they were treated in the same way as Daewoo," argues Lee Hahn Koo, a member of Parliament from the opposition Grand National Party. Kim's office denied any intervention. But, believing they could protect their investments by granting fresh credits, local banks—some state-owned—extended billions to prop up Hyundai Engineering & Construction and Hynix Semiconductor (formerly Hyundai Electronics Industries).

Chung Mong Hun thought these flagships of his group were just having a short-term liquidity crisis. But they eventually ended up in the hands of creditors—another blow to the old system. And now, Chung Mong Hun is dead, a victim too of the old ways that Korea must relinquish, in politics and business.

Seoul bureau chief Moon covers Korean business and politics.

A death shows that the *chaebol* remain dangerously entangled in affairs of state

MEMORIAL: *Did scandal drive Chung to suicide?*

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COMMENTARY

By Stanley Reed

WHO'S THE REAL ENEMY IN IRAQ?

American commanders hope Saddam Hussein's capture will soon end the Iraqi *intifada* that has claimed the lives of more than 50 Americans since major operations ended on May 1. But don't bet on it: Plenty of Iraqis with no special allegiance to Saddam still have reason to lash out at the Americans, from rising crime to revenge for the death of relatives. "I don't think the guerrilla activity can just be explained by former members of the regime," says Raad Alkadiri, an analyst at Washington consultancy PFC Energy who recently visited Iraq. "The opposition is growing on other levels."

This resistance poses a key challenge to L. Paul Bremer III, the U.S. administrator. By branding too many Iraqis as unsuitable to participate in the new regime, the U.S. may be increasing resistance to its presence. Instead, the U.S. needs to do a better job of convincing Iraqis they have a stake in the new regime.

In this shift of perception, task No.1 is getting a grip on the nature of the Baath Party, the ruling power in Saddam's regime. The Iraqi Baath Party had a membership estimated at 1 million to 3 million, and the common view is that all Baathists were incorrigible ideologues with blood on their hands. In reality, only a fraction of this number played violent roles under Saddam. Many people joined the party to advance their careers or because they admired its original secularist principles. Besides, in Saddam's later days, the real power stemmed not from the Baath, but from his clansmen around his hometown, Tikrit. These clans, numbering about 50,000, dominated the ruling class after the 1991 Persian Gulf War, when the Baathists' clout started to wane.

It's quite likely that the Tikritis are behind many of the attacks—and that Bremer will have no choice but to suppress them. As for the Baath rank and file, most were never die-hard Saddamists, and they could easily be rehabilitated and recruited to serve useful roles. A high proportion of the technocrats in the government ministries that ran Iraq's infrastructure were Baathists. The U.S. can ill afford to let their skills go to waste.

A quick learner, Bremer is starting to recognize these distinctions. After initially banning senior party members from government positions, he has since turned a blind eye as former Baathists run the Oil Ministry. "It was obvious that if you de-Baathified the Oil Ministry, you wouldn't have any managers," says Toby Dodge, a specialist on Iraq at Britain's Warwick University. In another reversal, Bremer is paying pensions to ex-members of the military. His decision to disband the armed forces without pay had created thousands of potential enemies.

The wider population of Sunni Muslims is another matter where crucial distinctions need to be made. Hardcore Saddamists from the Sunni triangle north and west of Baghdad are a small percentage of the Sunni population. The military assumed that Fallujah, north of Baghdad, was a Baathist stronghold. Wrong: It is simply a conservative Sunni community. After confrontations in which U.S. troops killed at least 17 people, the military wised up. It is forging ties to local religious leaders and has compensated relatives of the dead.

If convinced that the U.S. intends to marginalize them, the Sunnis could prove formidable enemies. Yet the 25-person Iraqi Governing Council recently appointed by Bremer won't allay such fears. None of the council's four Sunni members represents the rural areas of the Sunni heartland. "There is something wrong with the process," says Laith Kubba, head of the Iraqi National Group, a Washington-based exile group promoting democracy. "It is designed to please the big players."

Kubba advocates quick national elections for a second, broadly representative council to perform functions such as drafting a constitution. Critics also think the current council relies too much on exiles. "Bremer should depend more on advisers within the country and not on those brought in from outside," says Issam A.R. Al-Chalabi, a former Oil Minister. It's not easy telling friend from foe in Iraq. But it is essential to winning the peace.

Reed covers the Middle East.

CONFUSED Until the U.S. learns to distinguish friend from foe, it'll keep alienating more and more Iraqis

FORMER SOLDIERS PROTESTING: NOT ALL MILITARY MEN OR BAATH MEMBERS WERE SADDAM LOYALISTS

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2003 Taiwan Business Alliance Conference

e-know investors will be in Taiwan this October the 2003 Taiwan Business Alliance Conference AC). As the world's 14th largest trading nation with apita income of more than US$13,000, Taiwan is ng investors from around the world to tap into one s strongest economies. With average economic at 9% since 1970 and a forecast for this year of Taiwan has held its own as an Asian success story. formation technology products to biotechnology, has successfully invested in creating a high-tech, nergy manufacturing center where people are skilled and highly-educated. Investing in Taiwan is a winning proposition for companies who appreciate Taiwan's dynamic and flexible spirit of innovation, solid base for industrial development, internationally competitive high-tech products, high-quality human resources, large capital market, and economic and trade networks in a fast-developing knowledge economy.

Multinational as well as small and medium-sized enterprises will be making valuable connections and closing deals at this year's conference, tapping into Taiwan's sophisticated and economical manufacturing and production of high-quality and affordable consumer goods. Workshops, forums, seminars, facility visits, business matchmaking and exhibits will all be part of this 4-day conference on October 19-22 at the Taipei International Conference Center. Recently interviewed, Mr. Lin Yi-Fu, Minister of Economic Affairs answered some important questions about why Taiwan is an ideal investment destination for multinational enterprises in the age of the knowledge economy:

Yi-Fu
r of Economic Affairs

t gives Taiwan competitiveness in the international field?

ave an excellent geographic location at the hub of a-Pacific region, which facilitates the convergence rmation and resources and makes it possible for to serve as a gateway and develop into a central n for the information, resources, and trading s. Taiwan has built a solid manufacturing capacity, ering capability and logistics experience that have our IT industry third in the world in terms of tion value. Our capital markets have a strong tion, which provide opportunities for company start- pansions and the development of venture capital.

an has been called the small yet big island; where iwan stand in the global marketplace?

an's gross national product was US$288.9 billion in Its trade volume of US$243.2 billion in 2002 and as the 15th-largest global trading power in 2001; foreign-exchange reserves of more than US$166.3 ranked third in the world. The more than 50 years rt that the people of Taiwan have devoted to the pment of the island have borne rich results.

Q: Does Taiwan give foreign investors a global competitive advantage?

A: According to a recent survey by the Geneva-based World Economic Forum (WEF), "Global Competitiveness Report 2002-2003," Taiwan ranks third in the world (among 80 countries covered) in prospective economic growth, an advancement of four places from last year. This improvement is a reflection of the island's efforts during the past several years to encourage the development of high-tech manpower, expand incentives for research and development and promote the transfer of the fruits of technological R&D. These efforts have directly boosted the development and upgrading of Taiwan's technology, and have contributed to the strengthening of the island's economic power. Taiwan's diversified, well-educated and highly motivated work force of roughly 9.9 million people is our most valuable asset and greatest advantage, especially in the areas of science, technology, and high value-added manufacturing.

Q: Some Emerging Capital Markets are considered a good bet in these times of global economic turbulence. Is Taiwan's market a good investment?

A: According to a report from Standard & Poor's, thanks to the opening up of the establishment of financial holding companies, the amount of corporate bonds issued in Taiwan last year reached US$25.9 billion, tops among the emerging market countries of the world and accounting for 26.2% of the total US$98.9 billion in corporate debt issued in those countries. This performance shows that the technological standards and management capabilities of Taiwan's companies have won international trust, along with the favor of foreign investors.

Q: Which topics and industry groups will be covered at TBAC?

A: The conference offers two Summit Forums on the topics of Globalization and Localization and various workshops focusing on 12 industries:

Semiconductor and Microelectronics; Display and Optoelectronics; Precision Machinery; Materials and Chemical; Technical and Engineering Services; Headquarters and Business Services; Biomedical and Health Care; Communication; Trade; Commerce and Logistics; Transportation and Public Construction; Tourism; Recreation and Entertainment; and Finance.

Q: What is the gateway for foreign investors into Taiwan? Who will help investors to proceed smoothly?

A: For foreign investors, the Industrial Development & Investment Center (IDIC) is the gateway to Taiwan. The IDIC serves as the implementation, liaison, and service window for the Ministry of Economic Affairs' strategic alliance program. To help strategic alliance partners and other foreign enterprises develop their operations in Taiwan, it offers them a full range of services from information on Taiwan's investment environment and related laws and regulations, help in obtaining long-term resident visas, work permits, or training for their foreign employees, and assistance in setting up branch offices and factories in Taiwan, to helping foreign companies make contact with ROC government and private-sector research institutions and overcome obstacles related to land, water, and electricity supply, as well as cooperating in the holding of joint seminars.

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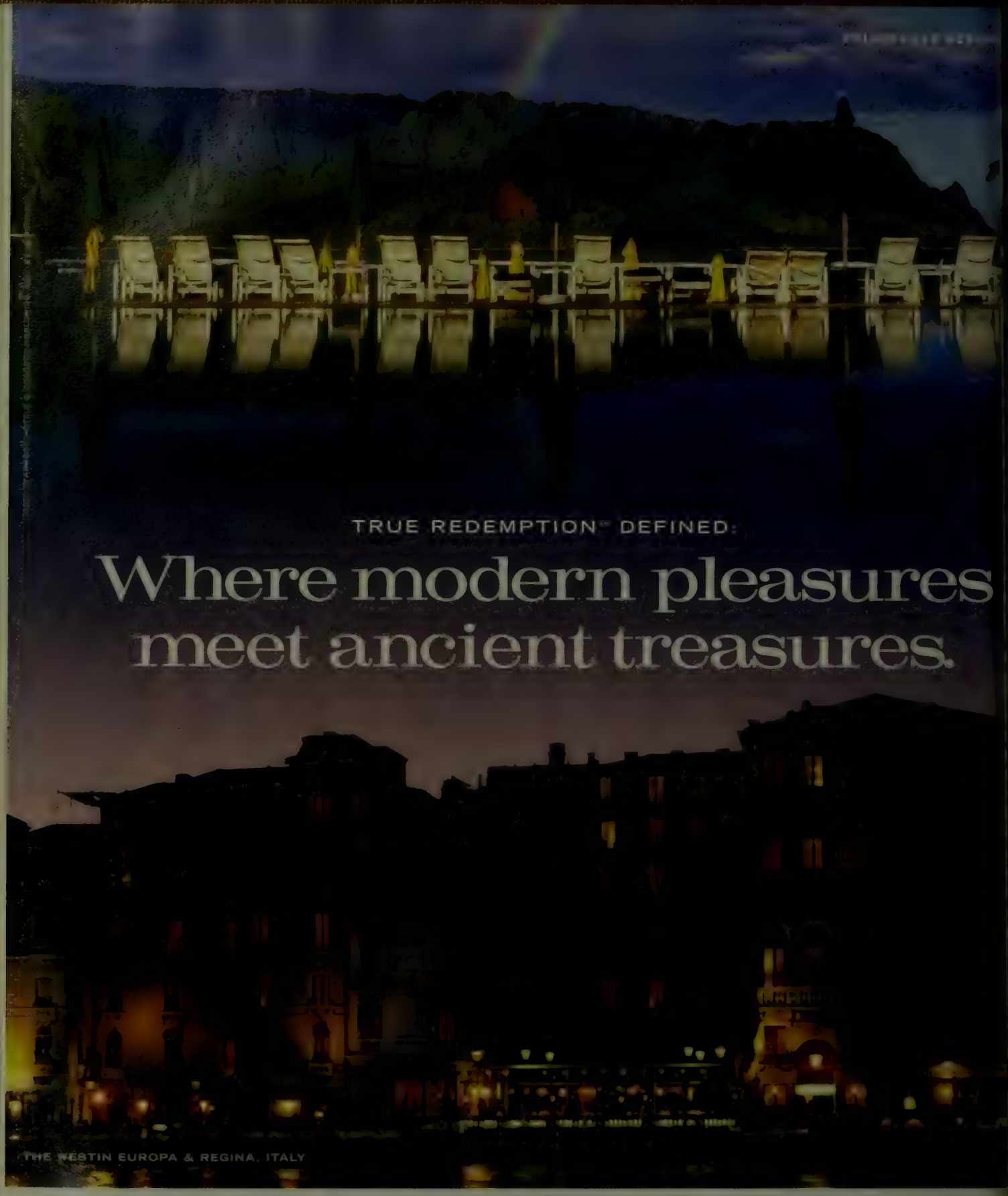

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ED BY ROSE BRADY

ORTH KOREA: TALKING IS ONE THING. ETTING SOMEWHERE IS ANOTHER

ooked like a major victory for the Bush Administration. July 31, word leaked out of Moscow that North Korea l finally agreed to a U.S. demand for multiparty talks on ntling Pyongyang's nuclear programs, which could oth- e be capable of producing six bombs within months. t the sense of triumph in Washington won't last long. tiations expected to begin in September involving North a, South Korea, China, Japan, Russia, and the U.S. are to be the most difficult and complex the Bush Ad- tration has attempted so far—way tougher than dealing Moscow on the antiballistic missile treaty or the U.N. ity Council on Iraq. The re- could set precedents for how ington deals with other ons proliferators such as Iran. e Administration faces a host ilemmas. Washington wants gyang to agree to the "verifi- and irreversible" dismantling nuclear operations—including lutonium reprocessing recently rted at a complex in Yongbyon highly enriched uranium pro- that Pyongyang admitted to October. That secret program violated a 1994 pact with the on Administration. Pyongyang s security guarantees, economic aid, diplomatic ties with J.S., and other goodies in return for disarmament. e U.S. has refused to give in to "nuclear blackmail," so could quickly bog down over who makes concessions Since Pyongyang has pulled out of several internation- reements, including the nuclear nonproliferation treaty, J.S. may be under pressure to offer carrots just to re- to last year's status quo. The North Koreans "have al- all the leverage," says Leon V. Sigal, a Korea expert at ocial Science Research Council, a New York think tank.

IN THE DMZ: *Will Washington offer goodies?*

The biggest problem, however, is coming up with safeguards to ensure that North Korean leader Kim Jong Il can't secretly restart his nuclear program. Achieving verifiable and irreversible dismantling will be impossible if Kim refuses to cooperate in a sweeping inspections program. Although the International Atomic Energy Agency successfully monitored the Yongbyon complex in the 1990s, Kim managed to hide his uranium program. A senior Administration official worries: "To be credible, anything we come up with is going to require a level of transparency well beyond anything in the past we've had with North Korea."

The Administration is betting heavily that multilateral talks—rather than Clinton's bilateral approach—will make a difference. Pyongyang's neighbors have a strong incentive to pressure Kim to get in line. But the neighborhood support may not be as united as President Bush might like. Chinese diplomacy helped lead to the talks—Beijing recently sent an envoy to both Washington and Pyongyang. But China is reluctant to cut off fuel to the North, as the Bush team advocates, because doing so could produce a flood of refugees.

If Kim Jong Il balks or fails to agree to intensive inspections, Washington will face a difficult decision. When Saddam Hussein refused to cooperate with inspections, Bush sent in the U.S. military. In heavily armed North Korea, that option is far riskier and could lead to hundreds of thousands of deaths. In the end, Bush may have to settle for not much more than an updated and expanded version of the 1994 pact with Pyongyang. Hobbling, rather than ending, Kim's nuclear ambitions may be the best the Administration can do.

By Stan Crock in Washington

GLOBAL WRAPUP

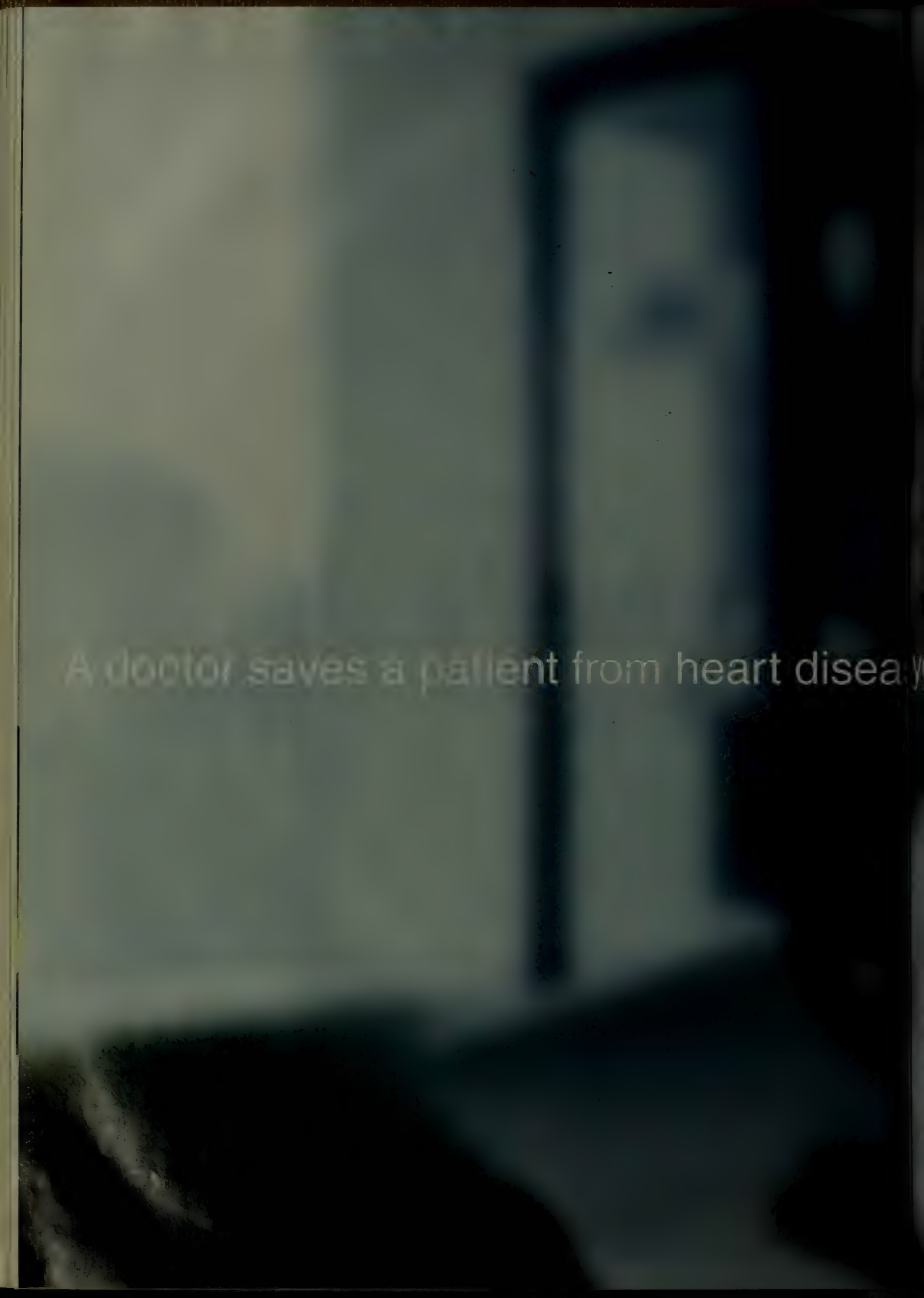
OLLBACK IN FRANCE?

rance's plan to take a 31% stake in bled French engineering giant Al- n underscores the center-right gov- ment's ambivalence about laissez- e capitalism. The Aug. 5 decision, ch European Union regulators mise to scrutinize closely, calls for government to acquire $339 million th of Alstom shares through a ned capital increase, while provid- an additional $226 million in loans he company.

At first blush, the bailout seems out of character for the government of Prime Minister Jean-Pierre Raffarin, which has called for curbs on public spending and continued privatization of partially state-held companies such as Air France and auto maker Renault. But with unemployment creeping up to 9.5%, the government was swayed by warnings from Alstom's banks that the company would go bankrupt without state aid, endangering more than 20,000 French jobs. Alstom lost $1.6 billion last year and is $5.5 billion in debt.

Similarly, the government recently approved a $10 billion credit line to heavily indebted France Télécom. And it has not demanded repayment of an emergency loan to computer maker Groupe Bull, due in June. Raffarin also has scaled back plans to trim the civil service, which accounts for one in five French jobs. With 60,000 public employees set to retire next year, he initially planned to leave half those positions vacant. But, facing protests from teachers and health-care workers, Raffarin now plans to eliminate only about 5,000 jobs.

By Carol Matlack in Paris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BusinessWeek

THE FUTURE OF TECH

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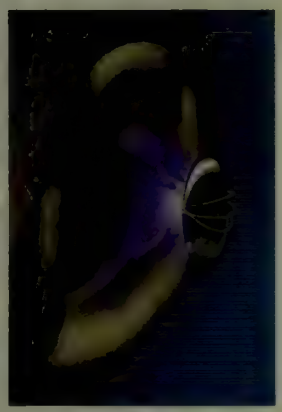

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WHY TECH WILL BLOOM AGAIN

Sure, parts of the industry have withered. But that's the way tech works, and new fruit is on the way

By Robert D. Hof

To hear some folks tell it, the information-technology revolution is kap The industry that has driven the economy and captured our imaginati for years has peaked for good, insists a chorus of skeptics. It's true t after four decades of 10% annual growth, more than twice the grov rate of the gross domestic product, tech spending has dropped for t straight years. And corporate IT chiefs say they won't increase spend more than 3% this year. Even some of tech's titans are starting join the dirge. "This is the new baseline," declares Oracle Corp. Ch Executive Lawrence J. Ellison. "The industry in total will actually shrink."

The doubts go even deeper than whether the industry will grow aga Burned by broken promises and bewildered by a dizzying array of hardware and software that's still underused, corporate buyers are more skeptical than ever. And now, some experts say that IT can no longer provide corporations any more competitive advantage—or growth—than such old-standby technologies as electricity. "A lot of the core things that businesses do have already been automated," says Nicholas G. Carr, who ignited a firestorm with an article in the May *Harvard Business Review* entitled "IT Doesn't Matter."

Does all this mean that, from here on out, tech will be—gulp—boring? Slow-moving? Inconsequential? It's true that some parts of info tech have probably seen their best days. Personal computers are so pervasive that they may not top 4% sales growth in coming years. Ditto servers, and mainstream corporate software may never reach double-digit growth again. Yet w seen this movie before. The same thing h pened to mainframe computers in the 1970s. buyers flocked to new, cheaper minicomput from Data General Corp. and Digital Equipm Corp. In the 1980s, minis declined as buy poured many more billions of dollars into che er, more flexible PCs and servers.

Fact is, tech has always has worked this w Like Italian mansions built with marble fr the Roman Forum, new markets emerge on foundation of maturing technologies. Lo prices make mass markets out of niche pr ucts. And mass markets inevitably mutate evolve into something unforeseeable. Only the mid-1990s, when tens of millions of peo had PCs, did it make sense to connect them, ing rise to what became the World Wide W Today, millions of people have laptops and ha

held computers—thus spurring rapid development of wireless networks. And more than 20 million U.S. homes have broadband connections. As fast Net access takes off, it will spark altogether new ways of using the Internet that we're just beginning to imagine today.

Simply put, tech hasn't settled down yet. Its days of maturity may be decades away. The IT revolution may share many parallels with previous transformative technologies such as railroads and electricity, but it differs in one key way: The underlying technologies not only aren't slowing down, they're accelerating. Computer-chip performance keeps doubling every 18 months, and disk-drive capacity and Internet-connection speeds are improving even faster. That's spurring new products, from MP3 and DVD players to Web services for corporations, that are disrupting industries from entertainment to health care. Says Intel Corp. Chairman Andrew S. Grove, who has worked in tech for more than 40 years: "The rate of change in technology is as much today as any time in my experience."

There will be no return to the foolishness of the dot-com boom

This rapid change also means that the savviest users of technology still have ample means to carve out an edge over laggards. Indeed, the titans of business today, from Dell to Wal-Mart Stores, as well as upstarts such as Amazon.com and JetBlue Airways, owe much of their leadership to using info tech in special ways. Each employs some of the same technologies, whether that's Linux software or servers based on Intel chips. But it's their expertise in deploying and customizing those technologies year after year that gives them a continued competitive advantage. "Everybody has always had access to the same technology. There's nothing new there," says Microsoft Corp. Chairman William H. Gates III. "The fact is that some companies have taken technology and used it more effectively than others. And the ones that don't use technologies effectively fall behind."

The debate over tech's value has exploded just as the industry is finally on the rebo From steadying orders and better-than-expe profits to the rise of promising technologies as the wireless Internet, Linux software, digital entertainment, tech's long winter is th ing. For the first half of the year, corporate spending rose 4%, according to preliminary nomic data.

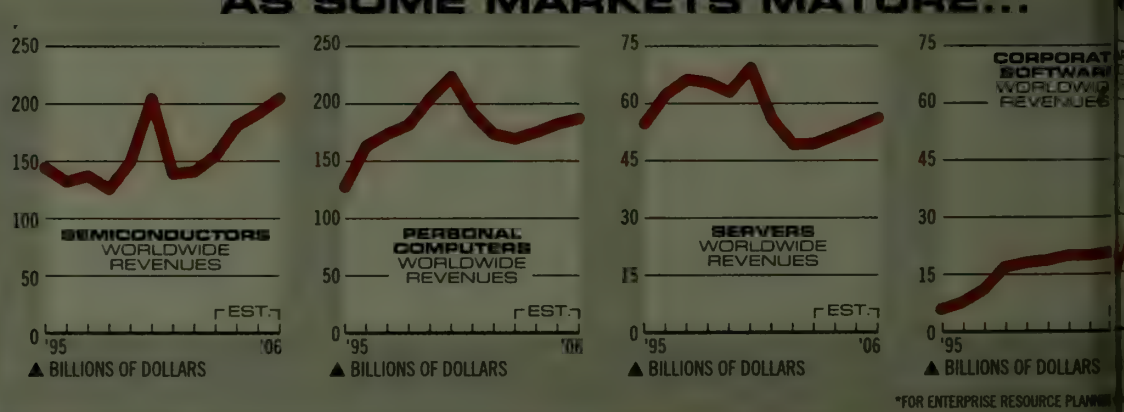
But let's be clear: There will be no retur the frothy foolishness of the boom. With weak economy, global unrest, and lingering s ticism by buyers, tech spending will prob recover to a modest 6% or so next year, and shy of its 10% historical average in 2005. biggest problem: Many IT buyers refuse to chase anything that won't guarantee a re in six months. "There's a big backlash aga technology and a lot of skepticism about wh can do," says technology consultant and au John Hagel III.

In stark contrast to the boom, nowadays customer is in the driver's seat, and tech c panies must come to grips with this rea This suggests a bracing shift in industry nomics and company behavior. Partly, it's lower prices will give customers more of te benefits—and profits. To accommodate th value-conscious customers, producers must f even more narrowly on what they do best outsource the rest to lower-cost providers. C panies increasingly rely on contract manu turers such as Flextronics International and Solectron Corp. to do the heavy lift And the process is picking up speed as com nies start to farm out basic design and gramming tasks as well to lower-paid work in India and elsewhere.

Just as important in this new post-fre period, tech suppliers no longer can act door-to-door salesmen, making quick deals skipping town. Instead, they need to be cra people, plumbers, teachers, and insurers, to slowing down, fixing software bugs and ha ware glitches before shipping products out door, and guaranteeing that their products p well with others. Says W. Brian Arthur, economist at the think tank Santa Fe In tute: "The main beneficiaries will be the V

TECH BRANCHES OUT

Several decades into the information technology revolution, some of tech's bellwether markets are slowing. Yet as they do, they're providing the foundation for a new generation of technologies.



s and the General Foods—the overall omy."

raft of new technologies hints at the prom- As everything from the transistor radio to c to the cell phone has shown, technologies attract entirely new waves of customers are key to tech's renewal. And they do it by ng tech not just cheaper but also much r to use. Wireless networks, for instance, extending the Web to the wide world by ng our electronic leashes. Networks of tiny ors give us a digital view into the physical d, allowing inventory to be tracked precisely and ultimately producing digital products that are much smarter, such as home-security systems that recognize family and friends. And corporate IT wizards are hard at work trying to make software available as Web services. The hope, ultimately, is that they can offer computing like a utility, as easy to tap as power from a socket (page 96).

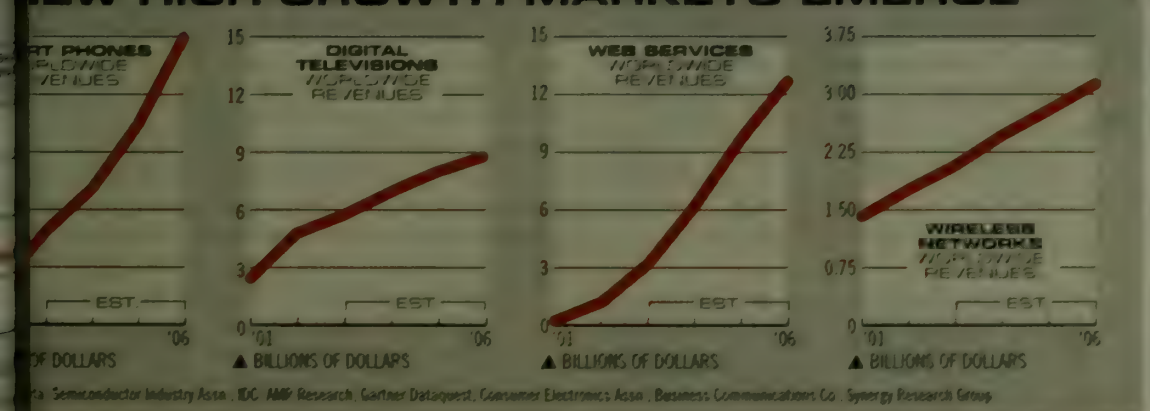
Getting there will be a wrenching process for everyone involved. Success and even survival in this new era will require big shifts in strategy by startups and giants alike. The largest and strongest may survive dwindling margins and slower sales by building huge economies of scale: Think Hewlett-Packard's purchase of Compaq, Oracle's hostile pursuit of PeopleSoft, and Dell's solitary romp through the computer industry. At the same time, many tech companies will have to adopt brand-new business models. Software makers, for instance, will have to switch from shipping shrink-wrapped boxes to providing services over the Net.

The economy depends on the tech industry getting this right and recharging its growth. Up to 10% of the gross domestic product comes from tech, which accounts for nearly 50% of all capital spending. Many economists believe IT's productivity benefits fueled much of the prosperity of the 1990s, so it's crucial that advances keep coming for our standard of living to improve (page 72).

Trouble is, obstacles abound. Tech's finance infrastructure remains a mess, with venture capitalists awash in money but timid about investing it in new ideas. Just 15% of venture capital has gone to early-stage companies this year, compared with 35% in 1995. Maybe you can't blame them: Corporate customers are wary of buying technology from startups that may

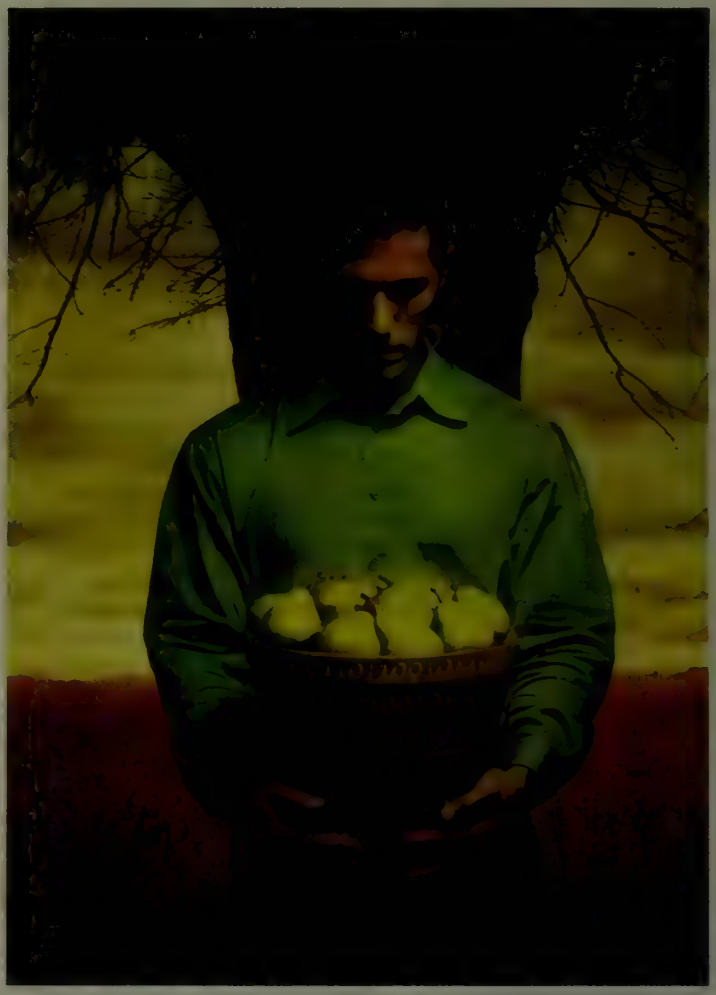
It's crucial that advances keep coming for our standard of living to improve

EW HIGH-GROWTH MARKETS EMERGE



Semiconductor Industry Assn., IDC, ABI Research, Gartner Dataquest, Consumer Electronics Assn., Business Communications Co., Synergy Research Group

"Steam engines and electricity went through one big wave of improvement—and not even one as big as the one for IT"



not survive. Legal and regulatory issues dog such potential growth markets as digital entertainment. Record companies and movie studios claim they lose up to $5.6 billion from illegal file-sharing and digital copying. And heightened fears about security and privacy could easily put the brakes on adoption of new digital technologies. According to the FBI, reports of Net fraud tripled last year, to 48,000 cases. In short, it's a mine field (page 114).

As disruptive as these transitions are, they're nothing new for tech. From the steam engine to the automobile, every technological revolution has suffered such cyclical downturns. Yet according to Carlota Perez, autho *Technological Revolutions and nancial Capital: The Dynamic Bubbles and Golden Ages*, they mark the end of a revolution. In ably, they set the stage for longest periods of growth—the economic golden ages lasting rou two more decades beyond the cr

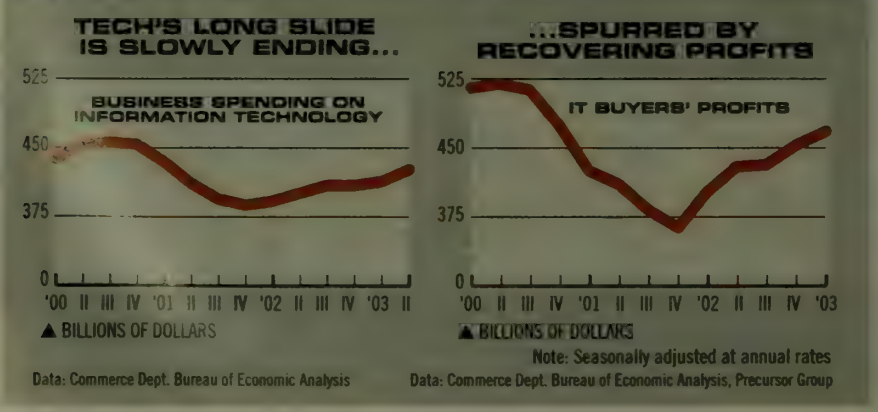
The last tech age, the mass m facturing revolution led by the a offers close parallels to info tech day. As the price of cars plumm early last century, sales rocketed. number of cars sold tripled betw 1919 to 1929. But financial specula following autos' "installation per got out of hand during the Roa Twenties, leading to what Perez the "turning-point recession": Great Depression. Today, that tur point is the recession, albeit less vere, sparked by the telecom dot-com meltdowns.

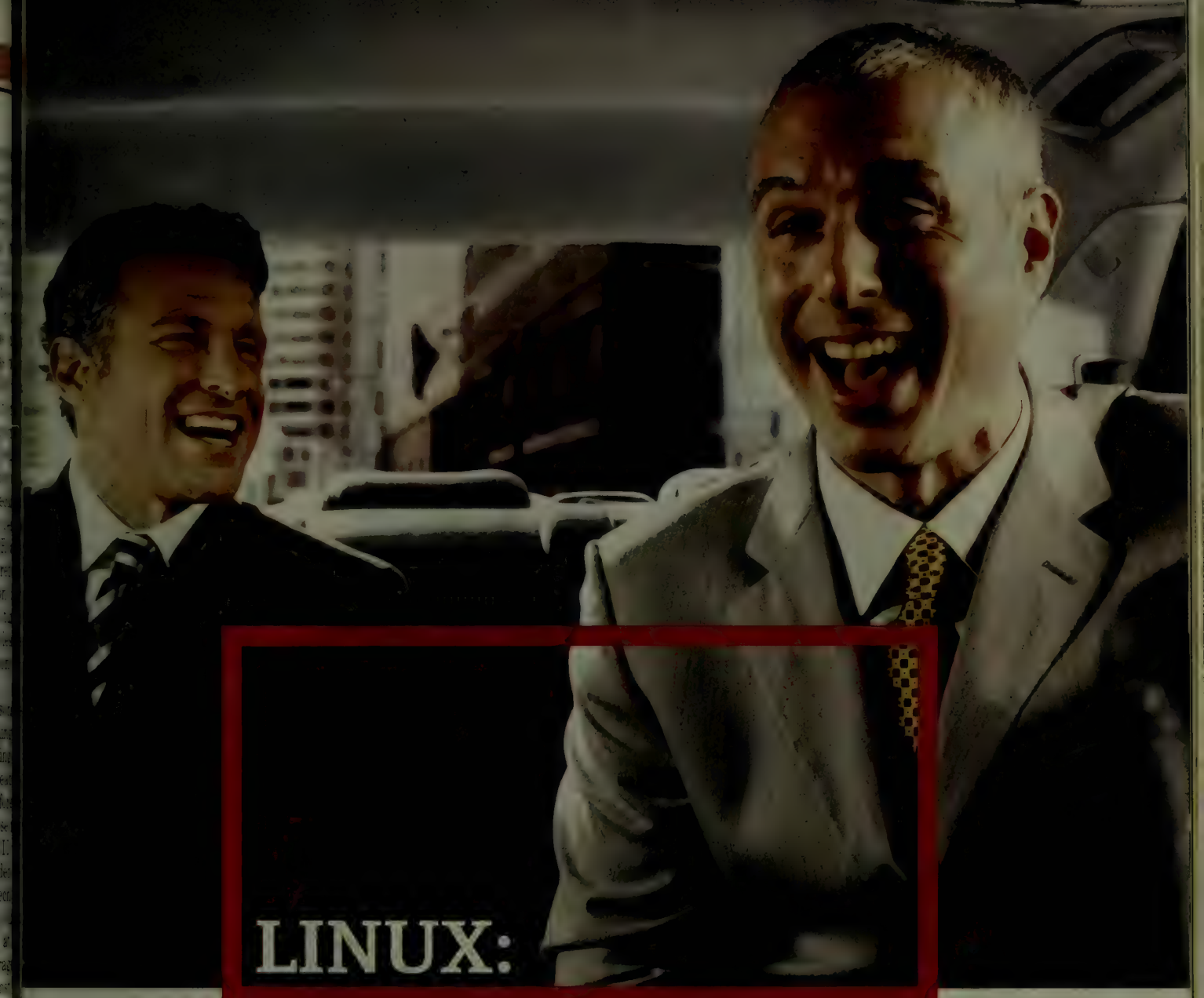
This is where the comparisons come most striking. Continuing prices driven by manufacturing ciencies, plus plenty of cheap pushed car sales up well before Depression was over. Sales rose n steeply after World War II through the 1960s—the golden of the automobile. Today, tech has its equivalent of cheap oil: relentless march of greater chip density at l er costs, plus even faster jumps in storage pacity and the accelerating spread of fast access. "Steam engines and electricity w through one big wave of improvement—and even one as big as the one for IT," says ec mist Eric Brynjolfsson of Massachusetts Insti of Technology. "IT keeps improving, year o year, exponentially."

Those improvements are starting to br tech buyers out of hiding. JetBlue Airways C has invested in a new technology called "v over IP," which lets corporate data netwo handle phone traffic using Internet protoc That allows its reservation operators to t customer calls from home—and not just to s on office costs. "They're a happier, more m vated, more loyal workforce," says CEO Da G. Neeleman. As a result, he says, JetBl call-center attrition rate is just 5%, vs. 30% dustrywide. That's helping JetBlue earn indus leading profit margins of 19% (page 144).

Buyers also are getting excited about ne emerging technologies that promise to m their operations more efficient. Wal-Mart St Inc. is making a big investment in radio-f quency identification (RFID) chips, which allow it and its suppliers to track goods all way from the factory to the checkout coun Such tracking is expected to reduce theft other losses, cut the number of people in w

WHY TECH WILL RISE AGAIN





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Legitimate file-sharing businesses could emerge to serve the music or medical industries

houses and stores who must track goods, and boost sales by making sure no item is out of stock. Sanford C. Bernstein & Co. estimates that by 2007, Wal-Mart alone could boost earnings 38% by using RFID widely. "It's a great example of where a pretty proven technology has a potential to have a huge impact," says Wal-Mart Chief Information Officer Linda Dillman.

Most promising are new technologies that appeal to the digital unwashed, potentially tech's greatest opportunity in the years to come. Less than 12% of the world's population has a PC, and, even with Net-connected cell phones and Internet cafés, just 13% are on the Web. One example of the new products: smart phones that are in every way computers, with Web connections and cameras. Gartner Dataquest expects revenues from such products to jump 140% this year, to $4.9 billion. Indeed, consumers can't seem to get enough technology. Some of the fastest-growing new markets are consumer products, from DVD players to MP3 players. Says Roger B. McNamee, veteran tech investor with Silver Lake Partners: "The consumer has gone from being a marginal opportunity to being a huge opportunity [for tech]."

To take advantage of these new opportunities, however, tech companies must reinvent themselves—fast. Instead of applying the advances of silicon, storage, and network economics to hiking performance on
isting products for the same old
tomers, they must turn those fo
to making products, existing
new, that are cheaper. That's a to
transition.

Intel, for instance, is strugg
to reconcile the billions of dollar
spends each year on chip facto
with the fact that many custon
don't need PCs with the latest c
So it's aiming at entirely new m
kets, such as cell phones, handh
computers, and networking g
whose much larger volume c
make up for their lower profitabi
Those three markets alone are a
tential $45 billion opportunity, re
ons market watcher Precursor Gr
Advisors LLC, compared with
billion for PC and server chips
also has vowed to give each c
wireless capabilities, hoping to r
that wave.

All the way up tech's value ch
it's the same story. As its PC-s
ware business slows, Microsoft
moving beyond its mainstay cor
rate market into new fields such
video-game players. That's incre
ingly forcing it to become a dif
ent company, selling not just bits
disks but machines and multime
programming.

The pain of existing tech suppliers, however
the gain of startups. Newcomers with solid te
nology, from Salesforce.com Inc. and its softwa
as-online-service to Google Inc. and its ace sea
engine, are still getting venture money and e
eyeing IPOs. There are also huge opportuni
in new IT services, suggests Intel's Grove. Just
Ross Perot created a multibillion dollar servi
business in Electronic Data Systems Corp., Gr
thinks startups could emerge to run legitim
file-sharing operations for entertainment com
nies or medical databases. Particularly prom
ing is that startups are getting funding for ri
new technologies such as nanotechnology and
mechanical livers (page 106).

This constant renewal is the essence of te
It was in the last big tech downturn, in 1985-
that some of today's titans got rolling—Dell,
one. Today, Dell dominates PCs, with sales hav
risen 14% last year, to $35.4 billion. Foun
Michael S. Dell's view today? "There's no sh
age of new ideas and new technology comi
The evolution of technology is showing no sig
of maturing whatsoever." The industry may w
require more steady leadership in the diffic
years to come. But for tech to remain a vi
part of the economy, its leaders must make su
they don't slow down as they grow up.

*Contributing: Wendy Zellner and Andr
Park in Dallas, Jay Greene in Seattle, and J
Kerstetter in San Mateo, Calif.*

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THIS GIFT JUST KEEPS ON GIVING

The 1990s boom in tech spending may be long gone, but it's still fueling productivity growth in many parts of the economy

By Timothy J. Mullaney and Peter Coy

Since 1995, productivity growth in the U.S. has doubled from its sluggish pace over the previous two decades, in part because of heavy investments in Internet gear and other information-technology equipment. It has been especially strong in industries that embraced the Internet with gusto, such as manufacturing, retailing, and financial services. But can information technology keep contributing to productivity growth? After all, the Net bubble has long since splattered, and corporate technology investment has tumbled from its peak.

The tech productivity boom may have stronger legs than most people think. A *BusinessWeek* analysis suggests that cost savings from IT investments in six industries alone could hit more than $140 billion a year by 2007—on top of the savings achieved from the rapid productivity gains between 1995 and 2002.

Four big reasons for tech's resilience stand out. First, industries that have lagged in productivity growth, such as government and health care, are slowly starting to get serious about tech investments. Second, retailers are slowly rolling out an industrywide project to standardize and maintain e-catalogs of the products they sell, setting the stage for a decade-long surge that ultimately could save store chains and consumer-goods manufacturers $50 billion a year.

More important, there is far more productivity stimulus still coming from the boom than most realize. When companies buy technology, productivity doesn't jump right away. It takes time to remake strategies and business processes to take advantage of the new hardware and software. A recent study by Massachusetts Institute of Technology economist Erik Brynjolfsson and University of Pennsylvania's Lorin M. Hitt says the biggest gains come five to seven years later. If true, last year's 4.8% productivity surge traces to investments made in 1997 or before. And that would mean big gains from the late-'90s technology spendathon are still coming. "There's a big learning curve," says James Q. Crowe, CEO of Level 3 Communications Inc., a telecom upstart. "We're still working with investments we made years ago."

The other big reason productivity will st strong is, paradoxically, the weak economy. I cause the recovery has been so sluggish, ret ers, manufacturers, travel companies, and finar firms still face overcapacity. To survive, comp nies have to keep wringing productivity ga out of tech gear they own now and resume least modest spending by next year. "They ha to do it, or they're dead," says Standard & Poo economist David A. Wyss.

For consumers, the best place to look tech-related productivity this decade will be t supermarket. More efficient food stores will dri costs savings in the retail industry that could $25 billion by 2007. The largest single slice that, as much as $10 billion, will come from industrywide effort to coordinate data shari among stores and suppliers of consumer pac aged goods. The project, dubbed UCCnet becau it's being coordinated by the Uniform Co Council trade group, will maintain manufacture product catalogs and distribute them to retaile

Bad data in supermarkets have been a hu problem for consumers and companies alik Stores order products they don't really need, manufacturers ship the wrong sizes, and both sides need to hire staffers to sort everything out. Simon Bell, an A.T. Kearney Inc. consultant who studied the issue for the Grocery Manufacturers of America, thinks stores and manufacturers each lose up to $2 million in profits on every $1 billion of sales because of bad data. "We have billions of dollars in waste," says Bill Grize, CEO of Ahold USA, which owns such supermarket chains as Giant and Stop & Shop.

While much depends on how fast UCCnet is

emented, Bell says the project could mean billion in annual cost savings by 2007. The r $10 billion to $15 billion in savings should e from smaller projects driven by retailers' spending. Home Depot Inc., for example, s to spend $360 million this year on cost-sav- nitiatives, including more self-service check- . It also plans to implement online learning, h will let experts train staff around the try on, say, a new power drill, using Web- d kiosks instead of visiting each store.

ike retailing, high-tech manufacturing had e-'90s productivity surge that should keep g. Most of the tech giants who led manufac- ng to 4.3% annual productivity growth be- n 1995 and 2002 say they can increase pro- ivity just as fast this decade. Intel Corp. is example. New forecasting software will let company react more quickly to changes in and, reducing the time it takes to shift chip uction lines from a month to as little as days. Just one such nimble maneuver can Intel $1 billion, says Chief Financial Officer y D. Bryant. With that and several other ects, Bryant thinks the chipmaker can boost uctivity by 10% a year.

he productivity outlook gets much brighter if th care and government perk up—and the ces are pretty good. Economy.com Inc. says ral government productivity will rise 1.7% a through 2007, compared with only 0.9% 1992 to 2002, because of increased spending T and more aggressive outsourcing. If tech es half of that acceleration, government ld save an extra $1 billion the first year, ing $5 billion a year by 2007. That's a big compared with the $260 billion economic ut of federal workers.

ne reason that estimate is reasonable: a new tegy released in April by the Office of Man- ment & Budget. Its centerpiece is 24 big tech projects, nearly all to be completed by late next year. Among the largest: a consolidation of 22 payroll-processing centers into just two, which will save an estimated $1.2 billion over 10 years, and online tax filing, which saves the Internal Revenue Service about $1 per return. By 2007, the IRS is set to accept more than 100 million e-returns, up from 40 million in 2002. That's $60 million in fresh cost savings annually.

Although health care will continue to lag behind in IT-related productivity growth because hospitals and doctors spend relatively little on technology, there are positive signs. Web technologies are making it easier to knit disparate computer systems. And high-tech hospital systems such as the University of Pittsburgh Medical Center are leading by example: By switching to electronic health records, the emergency room of one of its hospitals is handling 40% more volume over the past 18 months with no staff increase. Add it up, and Economy.com says health-services productivity will grow nearly 1% a year after shrinking 1% a year for the past decade.

To be sure, not every industry will get a big boost. Productivity in education will barely rise in the next five years. Most schooling demands personal interaction, and the most rigorous studies show no gains from computer-aided teaching. Harvard Business School Professor Clayton M. Christensen says the Web will find a niche letting small districts offer low-enrollment courses such as Russian or advanced-placement physics. But its biggest education impact will be in corporate training and university-level distance learning.

Despite the hand-wringing over the bursting of the Net bubble, information technology continues to contribute to productivity growth. And the efforts under way in several U.S. industries suggest that how far technology takes the economy may be limited only by the imagination. ■

An MIT study says the big productivity payoffs from IT outlays come years later. If so, huge gains are on the way

OND ACT: PRODUCTIVITY

ning five years, tech investments could yield **$140 BILLION** in annual cost savings

	SIZE IN* 2007	2007 COST SAVINGS	EXAMPLES OF WHERE THE SAVINGS WILL COME FROM
FACTURING	$1.6 trillion	$56 billion	With most sales online, tech leaders will push e-biz deeper into their operations
CIAL ES	1.1 trillion	44 billion	Lenders can cut the cost of processing mortgages in half by automating paperwork
LING	1.0 trillion	21 billion	An industrywide initiative to synchronize and correct data using the Web will slash errors
TH-CARE ES	630 billion	12 billion	Federal rules that streamline paperwork take effect this October and could save $30 billion over 10 years
RAL MENT	270 billion	7 billion	The White House is pushing the Web into every major department over the next 10 years
ATION	370 billion	1 billion	The biggest potential benefits of technology are in distance learning and self-directed study over the Net

.com Inc., BW *Forecast of value added by sector

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Founder and President
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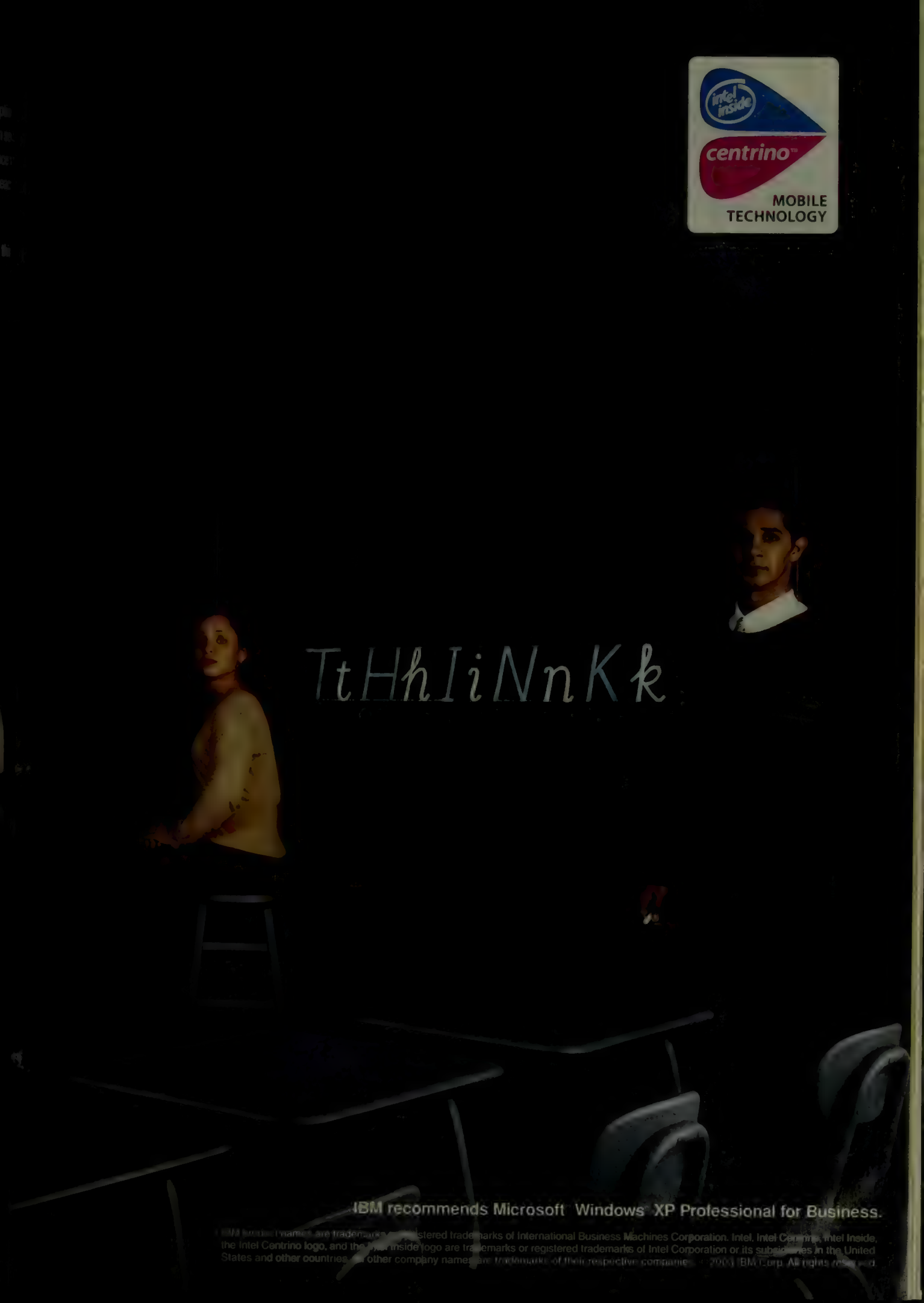
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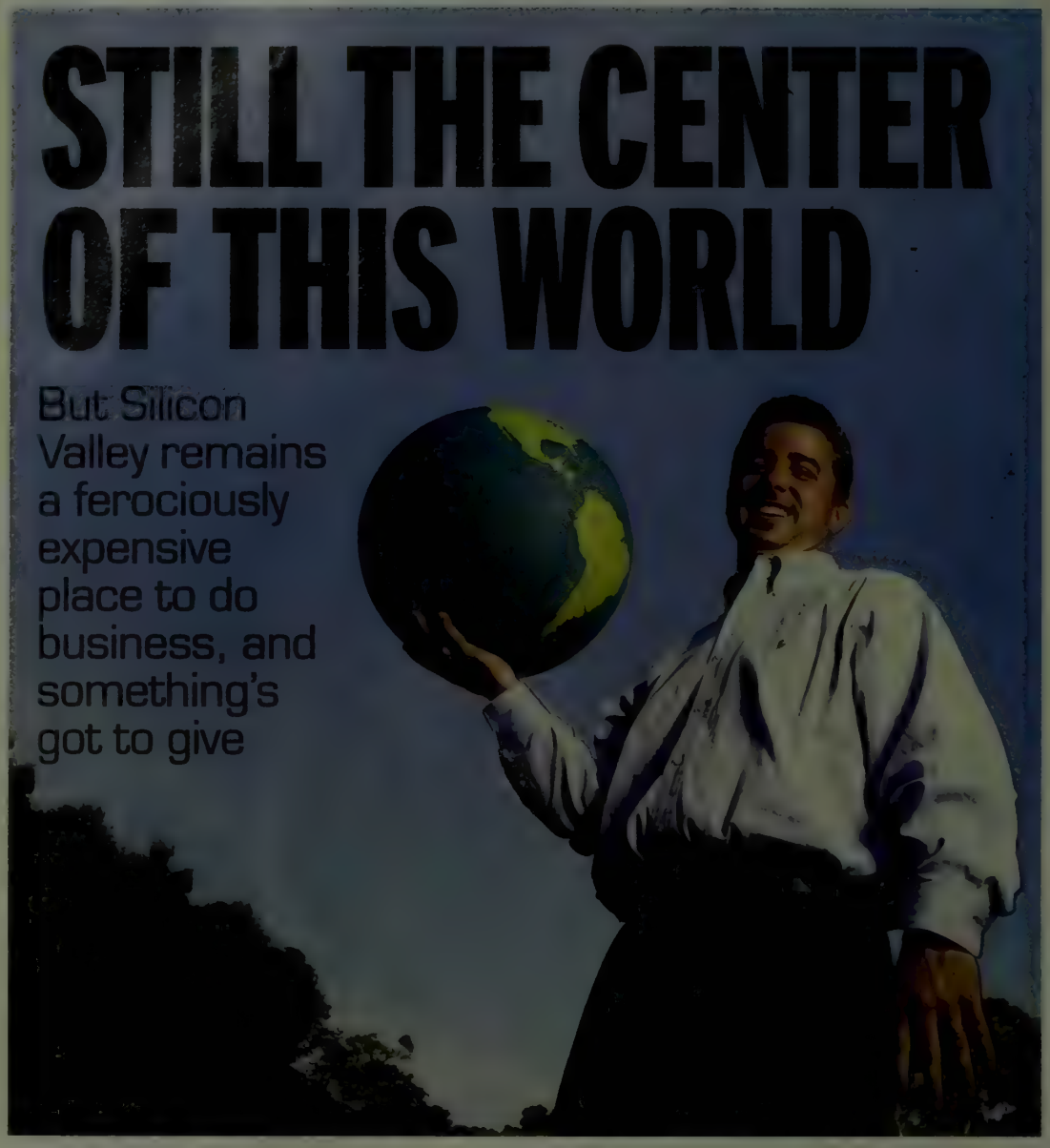
STILL THE CENTER OF THIS WORLD

But Silicon Valley remains a ferociously expensive place to do business, and something's got to give



By Jim Kerstetter

When Ben T. Smith started organizing a tech startup called Spoke Software last year, he couldn't imagine locating it anywhere but Silicon Valley. The Valley had the engineers, the tech marketers, the lawyers, and, most important, the venture capitalists. "There is nowhere else like this," he says. "Everything I need is right here."

Everything but an affordable place to do business. By the end of 2003, Smith plans to move 30% of his software engineering, or the next 10 hires he makes for his 50-employee company, out of Spoke's headquarters, a walkup space on a side street near Stanford University in Palo Alto.

Why? Despite an unemployment rate hovering at 8.5% and an office-vacancy rate that has quadrupled over the past three years, to more than 20%, the Valley is still one of the costliest places in the world to run a business. Sure, office space can be had at a quarter of what it fetched during the bubble. But a typical engineer still costs about $150,000 per year when health care and office gear are added in. "The economic model in the Valley no longer allows you to have all of your employees here," says Smith. So Valley execs are considering shipping jobs to places like Bangalore, Beijing, and Prague, where talent can be had for one-third the price. Even Boston is 20% cheaper.

Unreal Estate

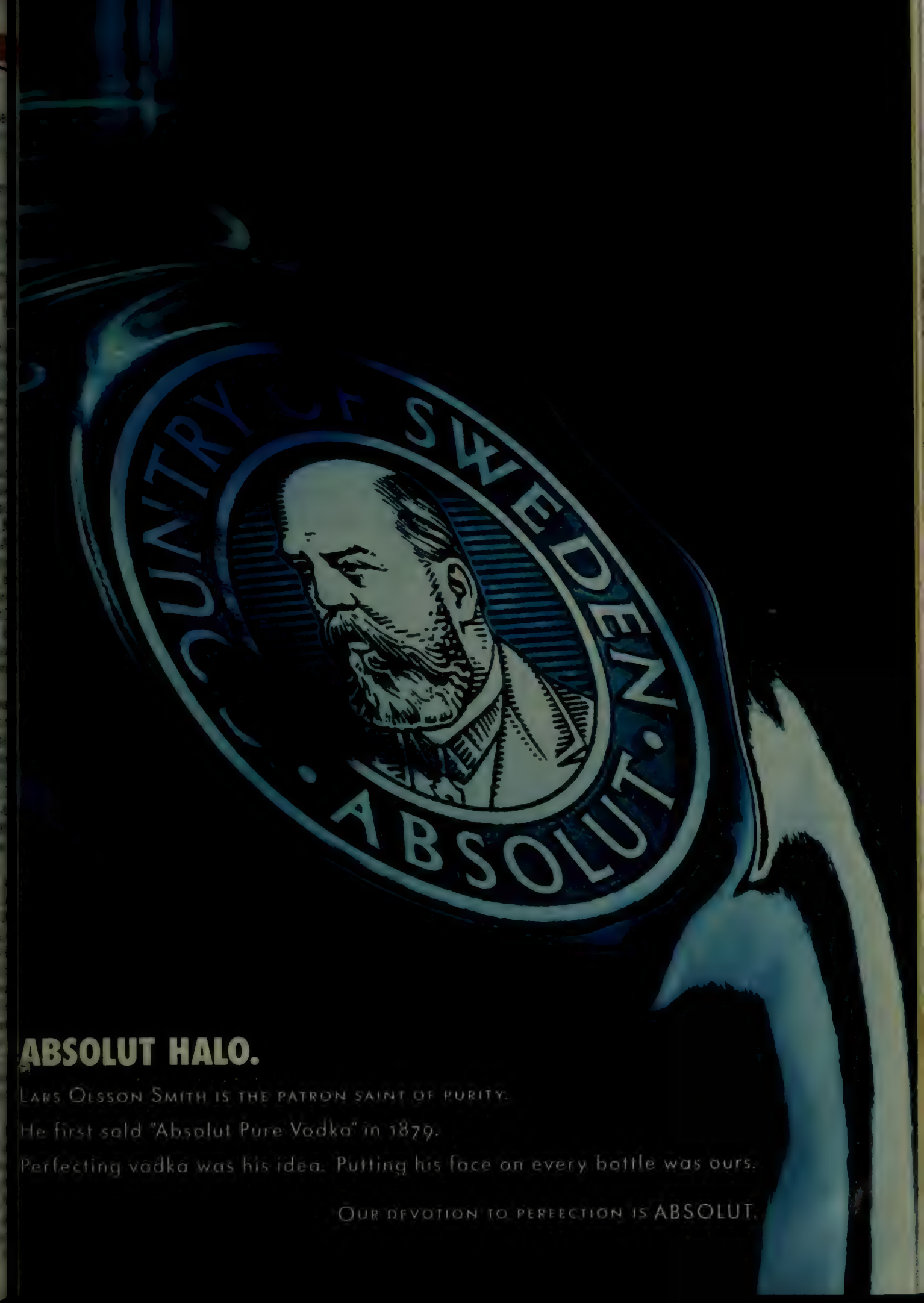
Ben Smith can't afford to keep all workers in the Valley

What's ahead for Silicon Valley is not a pretty picture. A place where entrepreneurs start to fulfill their dreams only to ship rank-and-file jobs to the hinterlands as soon as possible. Certainly, Spoke's hiring strategy doesn't indicate a rebound from the Valley's economic meltdown. From December, 2000, to April, 2003, greater San Jose lost 17.4% of its jobs, says Economy.com Inc. It was the biggest drop from peak employment for any region since the Great Depression—bigger even than the four years of losses, starting in 1978, that cut Detroit's workforce by 16.5%.

Confoundingly, local housing prices, the single biggest reason why employing people in the Valley is so darn expensive, haven't dropped with the rest of the local economy. The median price for a single-family home here was $565,000 in June—four times the national average, and up 3.7% from the month before.

Moreover, the biggest job losses of the past three years have come in the healthiest local sector of the 1990s: software. From 1992 to 2001 the software industry's share of the local job market tripled, to 21%, says Joint Venture Silicon Valley Network. Since then, it has been in a tailspin. Total Valley employment in software now hovers at around 100,000, some 22% less than its peak. Making matters worse, the area's biggest software makers are eager to hire in India. On July 10, database giant Oracle Corp. announced plans to double its Indian workforce to 6,000—just 1,500 less than Oracle's total in its Redwood Shores (Calif.) headquarters.

But before anyone writes off this 45-mile corridor between San Jose and San Francisco, there's a strong case to be made that the Valley will rise again. Although it has never before been taken down so hard or for so long, the local economy has always experienced wild booms and busts. In the mid-1980s, when the PC industry consolidated around a handful of companies, the



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a lost nearly 10% of its jobs. And while people d to think of the '90s as the days of vintage es and Ferraris for the local digerati, they re anything but that until Internet pioneer tscape Communications Corp. went public in gust, 1995. "When I got to the Valley in '94, it s flat dead," says Marc Andreessen, Netscape founder. Hurt by missteps in a tech fad called n computing, greater San Jose's unemployment rate climbed for three years, peaking at % in 1993. It didn't dip below 5% until the nth after Netscape went public. The Web eathed new life into the Valley.

What followed was an historic run. By December, 2000, more than 140,000 jobs had been ated in the San Jose area, according to the bor Dept. Then the bottom fell out. By April, 03, eight years' worth of job creation had been oed out. The total labor force also had runk—down 9% from its peak in 2000. That plains how the population of San Francisco, here many Silicon Valley commuters live, rank 1.5% last year, the biggest decline of any jor American city. San Jose's declined 0.6%.

But has the Valley's influence been erased ng with the jobs? Not quite. "I think the art money will be on Silicon Valley," says ger B. McNamee (page 122), a founder of Silr Lake Partners, a private equity firm in Men- Park. Optimists believe another job-exploding chnology will emerge because many sectors— e Internet, wireless, the digital home—are far m played out. One or more of those, they , will give the Valley yet another lease on life. ter all, there's nowhere else in the world with ch a dense concentration of the engineers and her specialists it takes to launch a company, litally, overnight.

Valley veterans also are quick to note that licon Valley is still where the venture-capital mmunity is putting its money. In 2003's second arter, 33.6% of the country's VC funds went to lley startups, two points higher than its share 1996. Venture capitalists, beaten and bruised ough they may be, haven't gone away. "Silicon lley occupies the same central place that it alays has" with investors, says John Doerr, a rtner at Kleiner, Perkins Caufield & Byers.

That's important because startups, not mare companies, create jobs. In the '90s, new lley companies hired 258,796 people, while exting companies lost 120,559 jobs, according to e Public Policy Institute of California. Even w, the best of the Valley's next generation of mpanies are hiring at a decent clip. While total mbers are hard to come by, search giant oogle Technology Inc. has doubled its workrce, to 1,000, in the past year. Internet auconeer eBay Inc.'s staff is up 72%, to 4,400, nce December, 2001. And SalesForce.com inc. s nearly doubled its local workforce, to about 5, over the past year. Recruiters for even nall startups claim the local job market is owing signs of life. "The phone is starting to ng again," says Jenny Harris, a recruiter for startups funded by Mobius Venture Capital.

Add it all up, and Silicon Valley is likely to remain the Hollywood of high tech. Smith's hiring plans for Spoke Software are not just about shipping jobs overseas. He's trying to offset the high-dollar creative talent he believes he can find only in the Valley with low-dollar rote jobs, such as product testing, that can be done outside the country. Entrepreneurs like Smith still believe that if you want to start a company and aspire to join the pantheon of tech stars—including Intel Chairman Andrew S. Grove and Apple Computer Inc. cofounder Steven P. Jobs—you need to be based in the Valley. "The general consensus is that the Valley is going to continue as the center for innovation in the world," says Kiran Karnik, president of the National Association of Software & Service Companies, a tech trade group in India. "Frankly, we'd like to move that to Bangalore, but I'm being realistic."

Will a new technology pop up to replace the 28,000 jobs lost at software companies, the 16,000 lost semiconductor positions, or the 15,600 lost computer-manufacturing staff? Oracle CEO Lawrence J. Ellison (page 120) says the Valley's next big employer could be biotech outfits. Certainly, biotech has fared better than any other tech sector, losing just 100 jobs. But it's hard to imagine total biotech employment, now only a third of the software industry, making up the difference. For the Valley to thrive again, something will have to pick up the slack. Of course, no one knows what that Next Big Thing will be, but you can bet more than a few of Silicon Valley's die-hard entrepreneurs are working on it.

Contributing: Linda Himelstein in San Mateo, Calif., and Timothy J. Mullaney in New York

The Valley is likely to remain the Mecca for startups needing top talent. Some less glitzy jobs will have to go

SILICON VALLEY SCORECARD

THE DOWNSIDES

- From December 2000 to April 2003, the Valley lost 17.4% of its jobs, the biggest drop from peak employment for one region since the Great Depression.
- Tech is slowly recovering, but software jobs are still moving overseas where an engineer costs $50,000 to employ vs. the Valley's average of $150,000.
- Despite a battering to the local economy, housing costs keep rising. The median price for a home here was $565,000 in June, up 3.7% from the month before and four times the national average.

THE UPSIDES

- Aside from housing costs, it's getting cheaper to do business in the Valley. Office space is $1.50 per square foot—one-quarter the price three years ago.
- Venture capital is still flowing into the region. In the second quarter, 33.6% of the nation's VC money went to Valley startups—two percentage points higher than in 1996.
- That's key because startups, not mature companies, create most of the new jobs. In the 1990s, startups hired 258,796 people, while existing firms lost 120,559 jobs.

Data: Economy.com, Sun Microsystems, California Association of Realtors, Joint Venture Silicon Valley Network, Thomson Venture Economics, Public Policy Institute of California

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NICK CARR: THE TECH ADVANTAGE IS OVERRATED

With his article in the May issue of the Harvard Business Review, *entitled "IT Doesn't Matter," Nicholas G. Carr might as well have painted a target on his chest. The former editor-at-large of the magazine contends that the strategic value that information technology can provide corporate buyers is falling as it becomes more pervasive. That view has elicited howls of protest from many tech execs and buyers, who believe that continuing technology advances provide plenty of potential to achieve a competitive advantage. But Carr hasn't backed down one bit. Now a consultant in business strategy and information technology, he's working on a book that expands upon his article. In an interview in July, Silicon Valley Bureau Chief Robert D. Hof asked Carr to explain himself.*

What led you to the view that information technology doesn't matter?

In the wake of the dot-com bust, there was a lot of copying of functionality across companies. A lot of what has been written about IT has been focused on what it can do, which is an enormous amount. But it hasn't focused on whether a company can do something with it in a different way or whether it's rolled out quickly throughout entire industries. That can lead to good things, such as increased productivity at the industry level. But it doesn't necessarily have much of an impact on individual companies and their ability to distinguish themselves and thus achieve higher profitability than their rivals.

> "Almost any innovation can be replicated by competitors"

Do you think the bust contributed to the lack of competitive advantage from IT that you write about?

That's a different issue. But I think there's a related aspect. Everybody said: "The Internet is great because it removes the friction from commerce." And that is good if you're a customer or an economist looking at business productivity. But it's often the friction in commerce that gives companies their profits. If you remove the friction, you're making it easier for customers to see through your cost structure and making it easier for competitors to replicate each other's strategy. In pursu that business model, a lot of companies we dooming themselves to fail.

Does the pervasiveness of IT mean there will less innovation now?

I'm not arguing that there won't continu be innovations in technology. I'm arguing t a lot of those innovations are going to go b yond the needs of a lot of companies. The h tory of IT has been one of different technol gies—whether we're talking about PCs or servers or networking gear or business-soft ware applications—evolving quickly to the point where they meet most companies' ne Every time they push it out further, they l more and more of their customers, who say "Gee, I don't need that," and switch to com modity gear or software.

Is there now less incentive to use innovative products?

Almost any innovation can be replicated competitors. So it's not enough to be the fi company to use this new, innovative techno gy and thus gain an advantage over compe tors. The question is: How long is that adv tage going to last? As the first company investing in it, you're going to pay a lot mo so you have to be assured of having that a vantage that allows you to charge more or produce at a lower cost long enough to rec that investment. The advantage that it has provided simply isn't lasting long enough to make it economically worthwhile.

Hasn't competitive advantage come from uniq use of the technology, not just from the techn gy itself?

It's always difficult to draw a bright line tween where the technology ends and the of it starts. But I would disagree with the gument that technology itself, the systems themselves, have never been the source of vantage. In fact, they often were. When a pany like American Airlines spent almost 1 years working with IBM to create its Sabre reservation system, it took a long time for competitors to copy that system. That syst itself provided the advantage.

Was it the system itself, or was it how they a plied it to their business?

It was the system, because all their competitors had to build that same system. Eventually they did, but it took too long, and Sabre was locked in. [Now] all the developments in technology—toward standardization, toward openness, toward greater power, toward ever more affordable hardware and software—have made it much more difficult for the systems themselves to provide you with advantage.

If all this is now widely available, why are Wal-Mart and Dell able to use the same technologies yet still get a competitive advantage?

I don't think information technology lies at the source of their strategic advantage. Wal-Mart's advantage comes from the complex system of things that it does better, from where it builds stores to its merchandising policies.

Dell's basic business model, and the source of its economic advantage, is its direct sales. That was in place back when it was taking orders with the telephone and the fax machine. Hewlett-Packard could replicate Dell's systems if it wanted to or needed to. They haven't because they have a completely different business model.

It's very revealing that, almost without exception, when people take issue with my argument, they say: "Look at Dell and Wal-Mart." But they built their advantage a number of years ago, when the ability of IT to provide advantage was greater. Where are all the other companies that have more recently gained advantage?

> "A lot of the core things businesses do have already been automated"

You compare IT to previous tech revolutions such as railroads and electricity. But some people suggest that IT is different—it's still evolving.

When you look across the earlier examples of technologies that were widely adopted and had a transformative effect on business, I don't think they were entirely different from it. Electricity is a good example. Back when it first became available, it was electric motors that could be adapted to all sorts of uses, just as software can. There was this long period where companies found creative ways to adapt their machinery and manufacturing to electricity. Today, they're completely hidden from us, because we take it for granted. It's not beyond imagining that over time, the same thing will happen with most basic IT functions.

Then where are we in the cycle of the IT revolution? History suggests the biggest buildout of a technology comes after the crash.

The buildout goes on for quite a long time, but whether it's the buildout of a commodity infrastructure or whether it's something companies use to get an advantage is a different question. It's always dangerous to say: "That's

I'm very doubtful that IT spending will grow faster than general increases in capital spending

it. It's over." But it's not as if there's this infinite, unknown quantity of things that businesses need to do that we haven't realized yet. A lot of the core things that businesses do have already been automated with information technologies.

A lot of new consumer technologies seem to be bubbling up that show little sign of maturing.

I think the real innovation in IT now is going to happen on the consumer side. You really do have this merging of IT and the whole entertainment and media infrastructure. When I look at the average home users of technology, their needs for innovative new software and for more processing power are greater than your average person working at a desk.

Since IT companies will be supplying consumers, directly or indirectly, will that prop up overall technology spending?

It would be dangerous for an IT company to assume the recent slowdown is purely a cyclical event. Of course, when business capital spending goes up, it's going to bring IT spending up with it. But I'm very doubtful that IT spending will grow faster than general increases in capital spending.

What should tech companies do to contend with the trends you outline?

The big challenge will be for companies that have built their businesses on proprietary technologies that they could sell at premium prices. There are a number of companies like that, whether it's EMC in storage, Cisco in networking gear, Sun in servers, or on the software side, even Microsoft with its operating system. If you're in that position, there are generic competitive products, whether it's open-source software or Dell boxes, that more and more customers are going to buy because they're cheaper.

Now, that doesn't mean I'd count out any of those companies. But it means they will have to figure out some new ways to make money. They're all trying. Microsoft is trying to extend its proprietary control over to Web services. EMC and Cisco are expanding heavily into services and trying to reduce their dependence on the basic equipment. How that's going to play out, I don't know.

Will we see a lot of disruption among companies that have been around for a couple of decades?

Yeah. When industries mature, there's a lot of consolidation at the top, and we're seeing that: HP and Compaq, Oracle trying to buy PeopleSoft. For the big companies, it becomes a scale and scope game—getting as many customers as possible and selling them as much as you can.

How will buyers use technology differently as these trends play out?

When a resource becomes a competitive necessity but doesn't provide strategic advantage anymore, then companies have to shift their focus from the opportunities it provides to the risks it presents. How companies use technologies is going to be focused on reducing risks. That includes things like security and reliability. But it also has to do with costs. If you manage your IT poorly and wastefully, you can definitely put yourself at cost disadvantage.

What's ahead for tech startups?

I don't think it's going to be as good as it was in the '90s. In fact, there can be new technologies that are quickly adopted throughout entire industries that improve productivity without giving any particular company an advantage. It's not inconceivable that a startup could pioneer a broadly adopted technology and grow quite handsomely. But it's going to have to prove its value to business. Startups aren't going to be funded with wishful thinking anymore. Those days are gone.

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ANDY GROVE: 'WE CAN'T EVEN GLIMPSE THE POTENTIAL'

For someone who stepped down from the CEO's job more than five years ago, Intel Corp. Chairman Andrew S. Grove still has his finger on the pulse of technology. Some 35 years after co-founding the Silicon Valley chipmaker, Grove, who also lectures at Stanford University's Graduate School of Business, believes information technology is far from mature. Here are excerpts from interviews conducted in January and July by Silicon Valley Bureau Chief Robert D. Hof:

Signs of a tech turnaround are mixed. What's going on?

We ended last year with an all-time record in industry PC microprocessor shipments. We ended the year with 1% revenue growth. So what does that say? People are investing in information technology. Somebody's buying those units, and somebody's deploying those units. Revenues don't show this because of price cuts. There's going to be some period of router shipments, PC shipments, server shipments, notebook shipments, that is not going to show any corresponding revenue growth. That has to take place to build a platform from which a financial recovery can come. I think it's happening. We simply have to go through a period like this.

> There are huge, huge things going on, and we are too myopic to notice

What will drive the recovery?

There are three legs for a unit recovery. One is Asia-Pacific, especially the emerging economies. A disproportionate part of the unit growth comes from developing economies seeing that competitiveness requires IT infrastructure and IT deployment. They are taking advantage of the [low] pricing to catch up.

The second element, which I think is going to be the most fundamental, is Internet traffic. It's not doubling every 100 days, the way people once said, but it's doubling every year. There's a long way to go before that's going to require laying more fiber. But all that fiber that is buried in the ground is not lit [operational]. So long before we need to dig more trenches, we're going to need to light more fiber, which is going to require an incredible amount of electronics.

The third leg is the applications driving all that traffic. At Christmastime, e-commerce vendors outgrew their physical counterparts by three or four times or more. E-commerce happening the way all the hype said it would Internet deployment is happening. Broadban is happening. Everything we ever said about the Internet is happening. Now, if this goes for some period of time, it is going to use up the capacity. I don't know how long. But wh it does, revenue growth will follow.

Some think tech is such a large portion of the economy that it will never again grow at its historic 10% annual level. Are they right?

I don't agree with that characterization. We're going to have a five-year period—200 to 2005—when there's no way revenue is go to grow anything like it did in 1995 to 2000. We expanded physical capacity to maintain a unsustainably high growth rate in 1995 to 2000. We have to balance that out with a fiv year period that is below the trend line by t same amount that we were above it. Both p riods average out to a growth rate that's pr ably not as high as we thought in 1995 to 20 but it's higher than 2000 to 2005.

Nicholas Carr's recent *Harvard Business Review* article says: "IT Doesn't Matter." Is information technology so pervasive that it no longer offers companies a competitive advantage?

In any field, you can find segments that a close to maturation and draw a conclusion th the field is homogeneous. Carr is saying com mercial-transaction processing in the U.S. an some parts of Europe has reached the top parts of an S-curve. But instead of talking about that segment, he put a provocative spi on it—that information technology doesn't m ter—and suddenly the statement is grossly wrong. It couldn't be further from the truth.

It's like saying: "I have an old three-speed bike, and Lance Armstrong has a bike. So w should he have a competitive advantage?" Be sides, it is outside of traditional commercial-transaction processing where info tech will have the greatest impact in the future.

Is Carr correct that commercial-transaction processing in the U.S. and parts of Europe is indeed mature?

Sure. Transaction-processing software or database software Revision 8 does not chang

from Revision 7 nearly as much as Revision 2 did from Revision 1. But that's not [all] information technology. Ask yourself: Is digital distribution of music saturating? If it is saturating, what is all the hullabaloo about? Is digital electronics applied to warfare saturating? Then what is it that we witnessed a few months ago? You're talking about different parts of information technology.

Also, not even commercial-transaction processing is uniformly used. Health care, an industrial segment that represents 15% of GDP, way underuses information processing. And a lot of the problems with health care would be improved if it used it to the same extent banks do. It doesn't.

> "Technology is like a river. The rate of change in technology is as much today as any time in my experience"

Why has Carr's article struck such a nerve?

Because we are in the third year of a recession, and people are anguishing. There is absolutely no strategic agreement on the next questions: Is the industry going to consolidate, or not? Is it heading toward outsourcing, or not? In semiconductors, is it heading toward integrated manufacturing or foundries? The industry is in terrible turmoil. People are going in all different directions trying to find the magic answer. Somebody comes in and says: "There's no magic answer because the whole industry's dead." But the industry is not dead.

How is IT evolving beyond traditional business computing?

A digital telephone call is information technology. MP3 players are information technology. *Finding Nemo* is information technology. TiVo is information technology. Cell-phone infrastructure and wireless technology are information technology. Now, what part of that is saturated?

What is all that leading to?

The world is being turned into a digital representation. Distance means nothing if you have a digital infrastructure. Anything digital is borderless. You cannot put obstacles in the way of digital technology flowing everywhere. Everything that has an information element can be digital, increasingly inexpensively.

That leads to wholesale personalization of everything. MP3 players are personalization. Digital delivery allows you to make your own playlist. Same thing is happening in television, with personal video recorders like TiVo. The same thing is beginning in medicine, with diagnostics and personalization of treatment. This is information technology. And I submit to you, it is very, very early. We can't even glimpse IT's potential in changing the way people work and live.

Given these opportunities, why are so many peo-

Wonderful ideas have a hard time getting funding. Tech is unstoppable—but it's delayable

ple in the tech industry still so negative?

One, people are in a s—ty mood. We are dealing with people whose stock prices are down 90%, who went from genius to bum to unemployed in a handful of quarters. Both they and their observers and their investors find it easier to accept that it is due to some cosmic trend, such as "information technology is tired and spent," than to others. Two, I think the media's uncritical acceptance of hype the past several years is flipping over to equally uncritical acceptance of the doom-and-gloom. There are huge, huge things going on, and we are too myopic to notice.

Are there threats to a robust tech recovery?

Oh, a million threats. Liquidity: These things cost money. There is lack of confidence in technology, causing people to sit on 1½% bonds in favor of investing in new technologies. Three years ago, when interest rates were substantially higher, people were pouring money into start-ups, which ran the money down the drain to ad agencies and to brand recognition and eyeball-building.

Today, wonderful ideas have a hard time getting funding. Technology is unstoppable—but it's delayable.

Is this a problem for the U.S.?

One of the reasons we are doing as well as we have is that so much of our product is being consumed and deployed in emerging economies. [But] we are letting our infrastructure age. They are rapidly catching up.

Will future innovation increasingly come from outside Silicon Valley and the U.S.?

Probably. In the best case, we are going to have a leading role, but with less distance between us and other regions, countries, societies. In the worst case, that leadership could dissipate. Digital technologies close the gap.

Let me just take one example that is absolutely frustrating to me. The U.S., for economic as well as scientific reasons, has been a magnet for the best and the brightest in the world. It is less of a magnet today, because we are accelerating the shutdown of the magnet by making immigration increasingly difficult. Picture today's immigration policies applied to the years before and during World War II, and what would have happened if foreign scientists were not allowed to work in the U.S.?

I don't try to paint a cataclysmic scenario that in short order we are going to lose our lead. But we are losing the lead every day. The distance between us and the rest of the world is eroding anyway, because knowledge doesn't stay contained and people don't stay contained and the opportunities are not forever regional. But we are helping that trend. That is not the thing to do for the decades to come.

What new technology might boost tech's fortunes once again?

I'm not predicting a miraculous technology that is going to be a must-have product. An alternative is an easier-to-deploy product. For example, wireless everything is eliminating the most labor-intensive and most cumbersome part of electronics, which is cabling. What has held back broadband has not been electronics, it has been cabling. What has held back things like home networking, living rooms with computing equipment connected to consumer electronics, is cabling.

Everywhere you look, there's a rat's nest of wires, with lots of maintenance. All that labor can be reduced by reuse of local spectrum. So Wi-Fi is one major example of that. It could be the last mile for broadband.

Is innovation continuing, or has the downturn slowed it significantly?

Technology is like a river. The rate of change in technology is as much today as any time in my experience. ■

July 2003

ÜBER AUTO

Der Neu Lexus RX 330. Fasstensietbeltz! p.31

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THE QUEST FOR THE NEXT BIG THING

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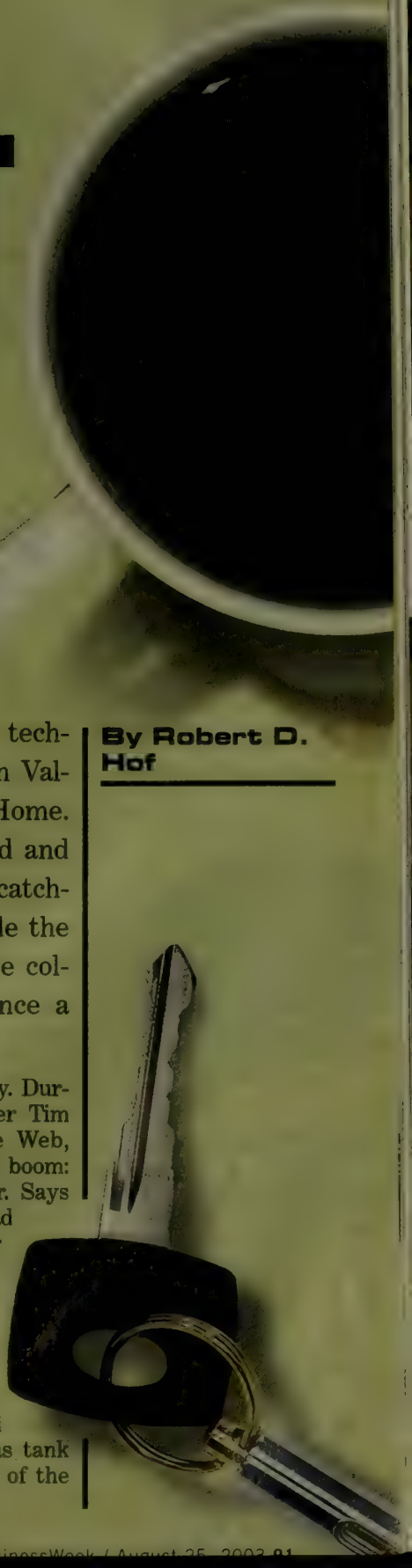


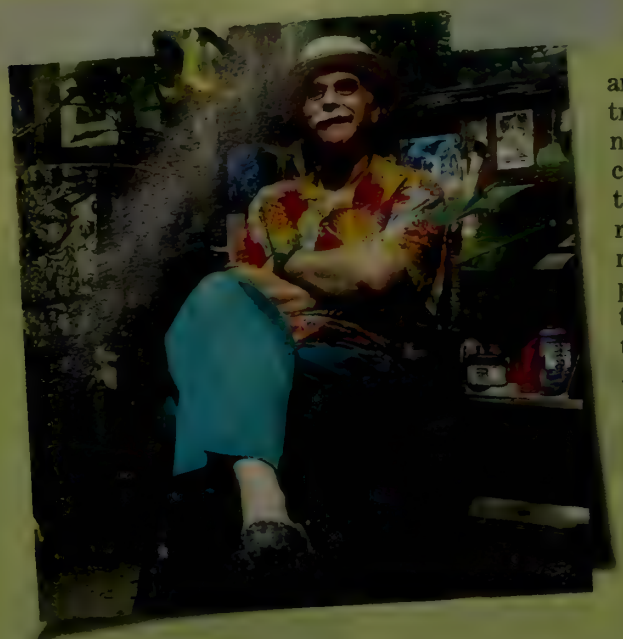
By Robert D. Hof

Every day on my commute, I pass within yards of a monument to technology's failed dreams. It's a sprawling office complex along Silicon Valley's main highway that once housed Internet portal Excite@Home. Drawn to it one day last year, as if to a haunted house, I parked and tiptoed up to peer inside. Utterly empty. Spooky. I remembered catching glimpses, as I whizzed by at 65 mph, of people bustling inside the green tinted windows, and I wondered where they all went. The collapse in 2001 of Excite@Home ended the bid of what was once a ng contender for tech's Next Big Thing.

e complex is still empty today. But a few ks away, another startup has taken resie in Excite's original headquarters. Ingrian works is a promising software security startacked by the high-powered likes of Sun osystems Chief Scientist Bill Joy. That set hinking that technology innovation works a ike a forest: Fires periodically sweep gh, seeming to destroy everything. Yet belong, grasses and wildflowers sprout from shes in a timeless cycle of renewal.

day, tech is poised between the dying em- of the bust and the first green blush of pturn. It's in fallow periods like these that eeds of tomorrow's Microsofts and Ciscos t. Out of the deep tech recession in 1985-86 a burst of new personal-computer applications that recharged a sputtering industry. During the downturn of 1990-91, researcher Tim Berners-Lee invented the World Wide Web, which led to the spark of the Internet boom: Netscape Communications' Web browser. Says serial entrepreneur S. Jerrold Kaplan: "Bad economies are the breeding ground for great leaps in technology."

Sick of writing about losses, layoffs, and liars, I was ready for such a leap. That's why, early last year, I joined thousands of curious researchers, hungry entrepreneurs, intrepid investors, and laid-off tech workers on the elemental quest of techdom. Notebook in hand, gas tank full, eyes wide open, I set out in search of the Next Big Thing.



The killer app of tomorrow, says futurist Howard Rheingold, will not be hardware or software but something he has dubbed "smart mobs"

My quest led me into every hallway and alleyway of tech. I tracked down entrepreneurs in mansions, cubicles, and garages, flew to Microsoft's gleaming research labs in Redmond, Wash., and probed visionaries coast to coast. In all, I talked to more than 100 people and heard dozens more at industry gatherings. My journey went from the ridiculous to the sublime: One morning, I watched a startup pitch a high-tech contraption to make fertilizer from cow chips. That afternoon, I visited Xerox' legendary Palo Alto Research Center (PARC) and saw computer chips whose microscopic circuits were literally printed using inkjet printers—a breakthrough that could produce disposable cell phones or ultracheap PCs.

Did I find the Next Big Thing? Truth be told, not exactly. But maybe, just maybe, I unearthed some trends that seem likely to produce something big. It will spring, I believe, from the proliferation of single-chip computers, tiny sensors, ubiquitous Internet connections, and even new tech-driven social movements envisioned by futurist Howard Rheingold. Together, they're forming a global digital nervous system whose potential impact seems almost limitless.

Regardless of whether all of that produces a blockbuster product or service anytime soon, my journey itself was the real reward. Sure, it was meandering, often leading down blind alleys. But it shed light on the process of tech innovation and exploded a lot of myths. For one, I discovered that many venture capitalists aren't so much visionary risk takers as sheep in wolves' clothing. No one else can so quickly build on a trend, and so quickly abandon it—leaving behind mass bankruptcies, layoffs, and a dearth of money for new startups.

I also learned that even the whizziest technology takes a long time to seep into our lives. GO's handheld computer went nowhere in the early 1990s, for instance, creating one of the Valley's biggest implosions. Yet only a few years later, Palm had a winner, and mobile digital devices of all kinds are among the hottest tech products today. In tech, says Paul Saffo, director of the think tank Institute for the Future, "it takes 20 years to become an overnight success."

Above all, I was struck by how many people at every stage in the tech development process, from entrepreneurs and researchers to the best VCs and savviest customers, are diving into the fray again. The spirit of innovation lives.

TOUGH TIMES FOR ENTREPRENEUR

One bright late winter morning last year, I st my search at what seems just the right pla startup incubator Stanford University and annual Conference on Entrepreneurship. So 300 students and young startup-wannabes ha come to network and attend panels on wha hot and how to raise money. But the real les begins after lunch. The keynote speaker is No Bushnell. He's the *über*-entrepreneur who fou ed video-game pioneer Atari and Chuck Cheese's Pizza Time Theater in the 1970s, p nearly 20 other startups since. "Venture ca talists are people looking for innovation—un they see it," he thunders. "If you have an in vative idea, your chance of getting funding virtually zero."

Cranky as he is, Bushnell has a point. Gr ideas often look trivial to most people. In f Harvard Business School Professor Clay Christensen has noted this pattern among m great technologies. The chip, for instance, st ed out suitable to run only lowly digital watch but eventually revolutionized all of electroni Still, Bushnell's latest venture—kiosks for barfl to play online games—seems an especially likely spark for a revolution. Anyway, I'm look for less jaded entrepreneurs.

That's why, a few weeks later, I'm at T Gong Show. Hosted at a Palo Alto hotel by entrepreneur support group Asia-Silicon Vall Connection, the event lets 12 p screened startups give presen tions to a panel of invest —two minutes sharp, or a go rings them off the podium couple, including a firm wh technology speeds drug disc ery, look promising. The rest serve (but don't get) an ea gong. Lawyer Bob Kohn pitch Laugh.com, which aims to g cell-phone subscribers to pa buck a month for George C lin's recorded joke of the d Isn't cell-phone service enou of a joke already?

The entries at the entrepreneur showcase The Gong Show included a joke-of-the-day for cell phones. But isn't cell-phone service enough of a joke?

Like the lottery player w hopes the next ticket will b winner, I keep attending th dog-and-pony shows over next few months. But I c find a pony among the dog

INNOVATION INSIDE

It's time to go to the w the scientists and researche Their ideas, after all, are fount of innovation. AT Bell Labs invented the t

or, and Xerox' PARC designed both the mod- PC that Steve Jobs commercialized at Apple nputer and the Ethernet computer network 's the standard today. In early spring, officials BM's venerable Almaden Research Center in Jose, famed for breakthroughs such as the drive, invite me to sit in on a presentation venture capitalists. It's about one of the est things around: nanotechnology, the engi- ring of materials down to the atomic level. Ve take turns using the scanning tunneling roscope in IBM Fellow Don Eigler's lab to e molecules of carbon monoxide around a er plate. Intriguing: It's proof of a path to rcome the big problem of nano, how to ma- late matter this small. Indeed, IBM would r announce that this technology has allowed n to create the tiniest circuits yet, a devel- ent that could keep electronics on its small- heaper path for decades to come. It sounds nising. But nano still feels like the next Next Thing—something that might blossom in 20 's, not two.

Maybe a place that produced one of the last things might provide clues to how the next emerge. That's what sends me to PARC in the of Palo Alto late last spring. It has a repu- on as a place that invents Next Big Things, as the PC, but fails to capitalize on them. So surprised when they actually knock my socks What grabs me most is a project working the tiny radio-equipped sensors called smart . Right now, the pieces of "dust" that PARC cipal Scientist Feng Zhao shows me in his ered lab are as big as a matchbox. But in a years, they may well be shrunk to 1 square meter, small enough to deserve their hopeful e. Ultimately, he says, there will be hun- s of times more of these than there are puters on the Internet. "It will be like a al skin on the face of the Earth," he says.

or Zhao, that's just the start. His group to create a sort of World Wide Web for ors, because, like computers, they're most l if they can communicate with one another. a search engine he calls a "Google for the ical world," a store manager might log on type in, "How many rolls of Charmin are " and get an instant answer from the sensor ork. They might even be embedded in roads easure traffic or in building materials to ct flaws.

sounds pretty futuristic. Except I find it's almost here, thanks to a up called Dust Inc. Founded by Kris r, the professor at the University of Cal- ia at Berkeley who coined the term smart , it has just started shipping its first prod- . Dust's contribution is technology that lets tiny devices create their own network—al- ng them to pass along data like a bucket ade, and thus they require very little power range. It already has sold some to Textron ground sensors to monitor troop movements to Honeywell International, which will sell them to supermarkets for monitoring energy use in refrigeration units. Cool.

It doesn't take me long to realize that most of the groundbreaking research in information technology came from the largesse of monopolies, such as AT&T and Xerox. So it's obvious where to go next: Redmond to visit Microsoft Research. It's spending $100 million on research by some 600 top programmers, engineers, and scientists. When I fly up for a tour, I'm treated to a series of pretty interesting projects. One researcher is creating ways to control computers and electronic devices through gestures. Another group is creating communications systems that seamlessly meld phones, voice mail, instant messaging, and e-mail.

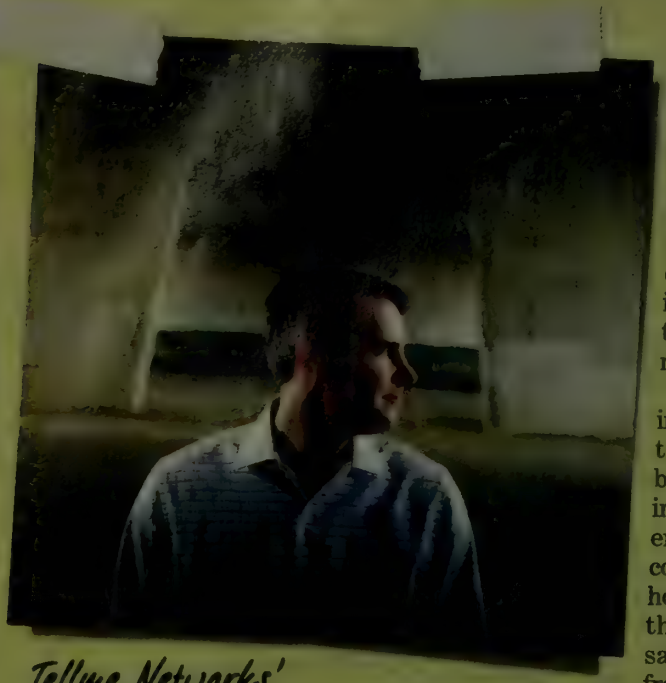
Kris Pister's startup is already shipping early versions of what's being called smart dust—tiny sensors that pass along data like a bucket brigade

Yet I can't shake the feeling that most of it will never see the light of day, simply because the research so far hasn't produced a big, disruptive winner. "It's hard to put a stake in the ground and say Microsoft Research did this really big thing," admits Senior Researcher Henrique Malvar. Microsoft Research isn't alone in this. The problem with research projects from corporate labs or universities is that "they come out of the womb with big heads and little arms and legs," says David Liddle, general partner at U.S. Venture Partners and a former PARC veteran who later ran the defunct incubator Interval Research. When I press Rick Rashid, Microsoft's senior vice-president of research, on why Microsoft hasn't been able to bust out and invent something really big, he says that's not their job. "We need to make sure that when something big does happen, we have the technology to respond to it," he says. I know this "fast follower" model has served Microsoft well. But I'm looking for something big enough to challenge

Windows, not make it even more dominant.

NOTHING VENTURED, NOTHING GAINED

It's time to meet the folks who put wheels on new ideas: the venture capitalists. Yet when I start my interviews in mid-2002 at the VC enclave of Sand Hill Road in Menlo Park, it looks like a ghost town. And when I sit down with Yogen



Tellme Networks' Mike McCue foresees a service that would allow you to pick up your phone and issue orders such as "call my friend Bob"

Dalal, a PARC and Apple Computer alumnus who's a managing partner at Mayfield Fund, it turns out he's a little adrift. "Quite frankly," he says, "I don't think anyone is proposing anything fundamentally new." Great.

Then he launches into a list of things that sound, well, big: He's interested in fledgling computer networks like Cisco Systems' that can host phone calls. He thinks instant messaging will blossom from an Internet party line to something like a digital concierge. And just-emerging voice-activated information services could make Internet services easily available over the phone, anywhere. In fact, I had just met a leader here, Tellme Networks, founded by entrepreneur Mike McCue. But Dalal's just not sure. That's one reason he's about to take a three-month sabbatical to reboot his brain.

Months later, when I check back with him, it turns out that instead of hitting the labs at U. C. Berkeley, as he had intended, Dalal tracked down old friends and visited art galleries. The break worked: He has funded a new company, PacketHop. Its technology lets people and companies create ad hoc networks by turning any mobile device into a data relay station. It sounds like yet another piece of my puzzle: something that lets people take network technology into their own hands and run with it wherever they will.

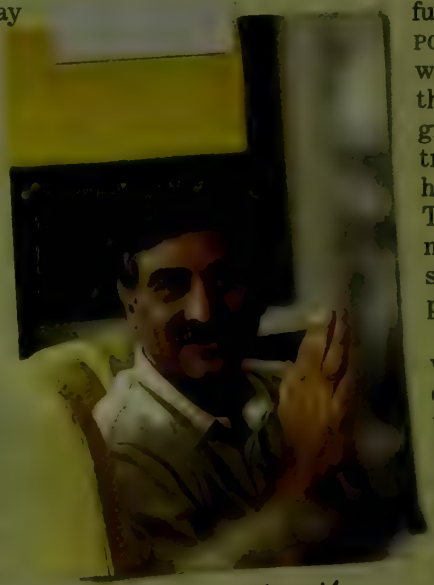
My next encounter with a venture capitalist, however, knocks me down out of the clouds. When famed Sequoia Capital partner Don Valentine, whose wins include Apple and Cisco Systems, returns my call, it's largely to dump on my quest. He thinks tech wrecks like the one we've just experienced are the direct result of amateurs and outsiders he calls "extraterrestrials" searching for the Next Big Thing. Still, it's hard to resist asking what he thinks it might be. After a long pause, Valentine finally answers, very slowly, as if to a child: "I wouldn't tell you that if you were my mother."

THE NEVER-ENDING JOURNEY

Finally, by early fall, after struggling to weav all these threads together, serendipity lends helping hand. Surfing the Web, I happen upon article by Howard Rheingold. The veteran te observer and author has a new book, *Sma Mobs: The Next Social Revolution*, that lin nearly all the things I've been tracking a much more: eBay's community of 30 million-p buyers and sellers; the runaway song-sharin movement; even al Qaeda's sophisticated use Internet communications. In all of these, Rhei gold sees a new social phenomenon driven by t collision of computing and communications mobile devices such as digital cell phones a handheld computers.

In early fall, Rheingold's idyllic backyard ga den in Mill Valley, north of San Francisco, pre ents a stark contrast to the ferment he se coming. Propping up feet clad in exquisite han painted shoes, he says these new devices a services will upset entire industries, from teleco to entertainment, and pave the way for new s cial institutions. Or at least some pretty o crowds. Activists in the Philippines, for instanc relayed instant text messages via digital c phones, marshaling hundreds of thousands people within hours to rallies that toppled Pre ident Joseph Estrada. It's not difficult to imagi this same dynamic transforming how compani organize supply chains and how consumers fi the best prices on cars. Says Rheingold, wh thinks this wave will be as big as the PC and t Net: "The killer apps of tomorrow will not hardware or software, but social practices." sounds a little scary. But maybe that's a mark something big.

All this hasn't yet jelled into something fully formed as the chip or t PC or the Web browser. B what I found convinced there are both new technol gies bubbling up that co transform our lives and hunger by people to use the To make a real difference, ul mately, technologies must tra scend gadgetry and becom part of the social fabric.



Venture capitalist Yogen Dalal is funding a startup that creates ad hoc data networks out of mobile devices

By the time I sit down write, it feels like the tech i dustry is finally starting turn around—and that may what I discovered has chance to produce somethi big. Indeed, the journey its made me realize thin weren't as dead as th seemed. It's possible the c alyst for tech recoveries really the collective efforts these kindred souls, all str ing to zero in on what's ne Maybe that quest nev really ends.

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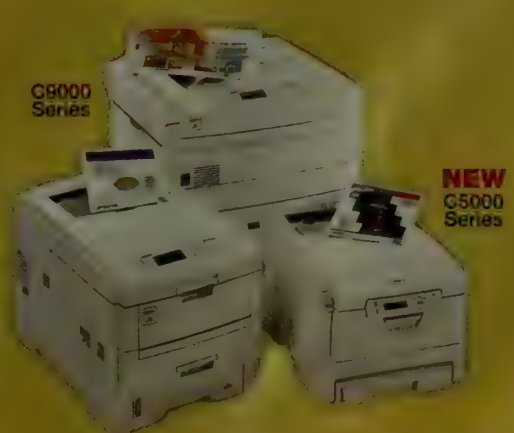

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Four Tech Waves To Watch

1 UTILITY COMPUTING

JUST TURN ON THE DATA

The idea is to make computing power into another pay-as-you-go service—like water or electricity. But beware of the hype

By Steve Hamm

The concept is one of the most compelling in the history of computing: Spare corporations a befuddling labyrinth of computers, software programs, data storage devices, and networks. Instead, make information technology as easy to use as plugging into an electrical outlet. This idea is commonly called utility computing, and many experts believe it's going to sweep the infotech world like a digital tidal wave. IBM, for one, is spending $800 million this year on marketing its vision of utility computing, which it calls e-business on demand.

Unlike past Next Big Things in computi this wave of innovation doesn't require corpo tions to rip out technology already installed replace it with expensive new hardware software. Instead, they can gradually add te nologies or services that make their comput systems more automated. As a result, much the cost and complexity is being wrung out. " think this is the third major computing revo tion—after mainframes and the Internet," s analyst Frank Gillett of Forrester Research.

The idea is that the power plant-like comp ing systems of the future will operate both at mote data centers and within a company's fices—under a variety of novel payment schen Whatever setup, the systems can be managed the company's own tech staff or by outside And rather than requiring customers to l computer servers outright for use inside th own walls, hardware makers, including IBM, Microsystems, and Hewlett-Packard, each o computing-as-used payment options. Ameri Express Co., for instance, today pays IB monthly fee based on the number of computer uses. It hopes someday to pay based on the tual computing power it consumes.

Problem is, there's still a yawning gap tween the hype being generated by the tech ants and the reality of what utility computin today. It turns out that purging comple is a mighty complex process in itself could take a decade or even lon for the bulk of computing to come as easy to tap as elec current. Even corporate b ers that are interested moving cautiously. "It

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ARRIVE SAFELY

great concept, but it's not quite mature enough," says David Bergen, chief information officer at Levi Strauss & Co.

There's danger in all the hype. The world is just emerging from the dot-com bubble, when some tech companies promised customers the sun, moon, and stars but delivered only meteor showers. The last thing once-burned tech purchasing executives want to hear is that there's yet another tech cure-all on the horizon.

"This the third major... revolution—after mainframes and the Internet"

It's no wonder tech purchasers are wary. The utility term was one of several trotted out in the late 1990s to describe a new form of computing—where independent companies ran corporations' whole range of computing tasks in remote data centers and delivered computing power over the Net, charging a monthly fee. That didn't take off. Most corporations weren't comfortable farming out crucial operations, and the technologies for managing such computing systems efficiently and dependably weren't quite ready.

Companies say their new ideas for utility computing are different. And they are becoming increasingly aggressive marketers. IBM's vision, called e-business on demand, includes a role for its huge consulting arm to help customers set up computer utilities. HP has a strategy called the adaptive enterprise, which some of its customers are tinkering with in-house. Sun's approach, called N1, also aims to make computing more manageable within a corporation's own facilities. Microsoft Corp., meanwhile, has a dynamic systems initiative aimed at automating computer systems, whether they're handled in-house or by a utility computing service supplier—such as IBM or Electronic Data Systems.

Everybody agrees there's plenty to be done to make computing less complex and more efficient. Because of complexity, 75% of the costs of operating a corporate computing system come from staffing, consulting, and maintenance. Adding to the problem is that many server com puters are dedicated to a single application accounting, supply-chain management, or huma resources. That's wasteful. Market researche estimate that most servers are used at only 20 of capacity. New technologies let software pr grams and the data related to them be routed different servers, storage devices, or sections a network—depending on where excess capaci exists at any moment. There's a minimum human intervention. Tech suppliers believe th can raise utilization to 50% to 80%, thus requi ing less gear. "We're using technology instead people to manage computing," says Nora D Denzel, senior vice-president for software Hewlett-Packard.

Some of the technology is real today. HP sa a product called the Utility Data Center that essentially a switching device for doling out com puting jobs. A customer's entire network wired to the machine, so an application can switched to any computer server or storage de vice on the network. Other tech suppliers a pushing hard in niches. Veritas Software Cor sells software that anticipates when addition storage capacity is going to be needed and aler operators to provide it.

Not all elements of the utility-computing co cept are ready for mainstream corporate us One that still faces major challenges is so-call grid computing. Unlike the Utility Data Cente which moves whole programs between ma chines, grid computing usually chops computa tion-heavy tasks into small pieces that a farmed out to dozens or even hundreds of com puters, taking advantage of underutilized ma chines. IBM, Sun, and other computer compani sell grid technology and or services that com panies use for scientific or financial numbe crunching jobs. Many corporate software pr grams don't benefit from this kind of slici and dicing. But for those that do, such as nancial calculations and pharmaceutical researc the tech companies are trying to make it easi to parcel the tasks out to grids.

The most difficult part of utility computi might turn out to be getting the big shots agree on standards. Typically, companies pref to use their own proprietary technologies. On July 21, for instance, storage leader EMC Cor released what it claimed was the world's first a tomated billing system for storage devices—a lowing precise, utility-type payments to be ma for storage services rendered. The drawback f customers: It works only on machines made EMC. Utility computing won't deliver on its pro ise unless devices made by different manufa turers work together as one.

Because of these unresolved issues, cynics s this new utility is doomed to produce more he than light. But the quip misses the mark. If t industry stays focused, bits and bytes cou some day be as simple to deal with as watts.

Contributing: Peter Burro in San Mateo, Ca

CAN COMPUTING BECOME A UTILITY?

Computing power could be as simple to tap as juice from a socket, if these obstacles can be overcome:

- **TASK-SHARING** It's too hard for computing systems to parcel out processing jobs in response to shifting demand
- **PRICING** New metering techniques are needed to figure out exactly how much power is being consumed
- **HYPE** Some tech companies are over-promising on the idea, which could turn off wary corporate buyers
- **STANDARDS** Technologies need to work seamlessly together under clear industry standards

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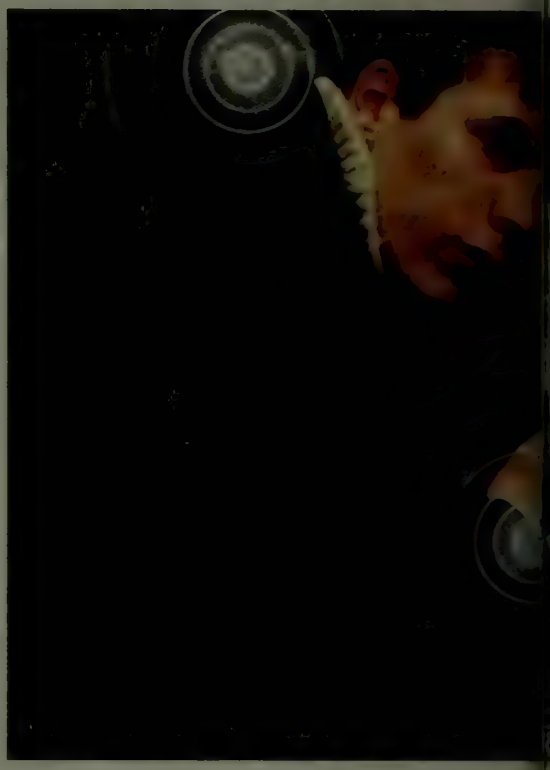
2 SENSOR REVOLUTION

BUGGING THE WORLD

Soon, sensor networks will track everything from weather to inventory

By Heather Green



It's a midsummer evening off the foggy coast of Maine. A small, black bird called a storm petrel swoops into an underground nest. Instantly, a tiny computer inside the burrow registers the bird's arrival and sends an alert through a wireless network. Throughout Great Duck Island, 200 similar computers linked together are tracking the weather, winds, and movements of these enigmatic birds, which for mysterious reasons prefer this island to all others. Naturally, the project, sponsored by Intel Corp., interests ornithologists. But it's far more important to the computing world: Duck Island is a laboratory for a new stage of computing known as sensor networks.

Take a look at the computer under that nest, and you would think technology was marching backward. It has minimal computing power and is capable of only two or three simple jobs, such as detecting heat given off by the bird's body and measuring weather temperatures. Primitive stuff. Yet a far-flung galaxy of these simple machines, each equipped with eyes or ears, chemical, motion, or temperature detectors, is anything but simple. The nodes pass information from one neighbor to the next, as though skipping across lily pads in a pond. And at a control center, a far more sophisticated computer harvests all this data and makes sense of it.

The appearance of tiny trackers almost everywhere is stirring fears of government and corporate intrusion

Already, companies from British supermarket Tesco PLC to Shell Oil Co. have deployed first-generation systems to monitor inventories and check the status of pumps at gas stations. That's just the beginning. Within five years, these sensor computers could be shrunk to the size of a grain of sand and deployed over much of the globe, resulting in thousands of new networks. Look for them to be scattered across farms and battlefields to monitor minute chemical and temperature changes and slapped onto trucks and shipping boxes to trace inventory automatically.

Sensor networks promise a mammoth extension of the Internet. To date, the Web has been a showcase for the human brain. It specializes in words, numbers, music, and images that mank produces. With sensors, the network stretches the far vaster field of global activity. This me such networks can cover every single thing t moves, grows, makes noise, or heats up. Pot tially, much of the world will be bugged. Mo over, those bugs will be doing most of the wo "Most of the data traffic won't be between hum beings this time around but between these silic cockroaches," says Bob Metcalfe, the network pioneer who has invested in Ember Corp., a s sor-network startup in Boston.

The sensor revolution has its beginnings two basic forms. R tailers are experime ing with the simp variation, a so-call radio frequency ID t or RFID—a next-generation bar code. Take a dio reader into a warehouse packed with RF tagged goods, and each item promptly iden fies itself, all of them joining to create up-to-date inventory. These tags cost 20¢ could cost only pennies within two to thr years. Far more sophisticated sensors now c $50. They create their own networks, like t one on Duck Island, and perform trickier jo such as running computations.

These diminutive sensors already are stirri up fears of government and corporate intrusi Billions of tiny tags could track everything fr people's shopping patterns to movements of s pected criminals. Privacy concerns will lik grow as sensors make their way into paym systems, are placed inside tires as ID devic and are tacked onto traffic lights and signs. June, privacy groups led protests over plann

of RFID tags in a Wal-Mart store. The retail erhouse canceled the project, saying it want- o focus first on a plan of getting tags on of its shipping cases by 2007. "There hasn't an effort by the industry to explain to any Schmoe what this technology can and can't says analyst David Krebs of researcher ure Development Corp.

ompanies are eager to overcome such ob- es—and cash in on the huge potential of or networks. York International Corp., which ages ventilation systems for more than 0 customers, plans over the next five years stall hundreds of thousands of networked ors on its clients' air-conditioning units. e will monitor temperatures and automati- send updates to York's offices. That should en the workload for York's 2,000 techni- , boosting productivity by as much as 15%. or all the promise, plenty of work remains. key is to make sensors with an energy sup- hat will last for years. This means tapping or kinetic energy, or tweaking systems so they draw only tiny bits of battery energy. Another challenge is to hammer out industrywide standards for sensor hardware and software.

One emerging standard may be Tinyos, an open-source operating system developed at the University of California at Berkeley. Backed by Intel and a host of universities and startups, Tinyos works on fewer than 8 kilobytes of memory—the size of a short e-mail. "It's extremely flexible, and it's open-source, which is important with the market still in a chaos phase," says Mike Horton, CEO of Crossbow, which has used Tinyos in test networks to track car parts.

For now, sensors are too expensive for most massive rollouts. It will take technical improvements and volume orders, such as those expected from Wal-Mart Stores Inc. and its suppliers, to drive down pricing. But the U.S. military already is laying out plans. In tests, it has dropped tubes containing 10 to 20 sensors from an airplane. Once they hit the ground, the tubes explode, sending the sensors flying. Then they establish connections among themselves and monitor enemy vehicle or troop movements, sending the data wirelessly to planes overhead.

Other early applications are more mundane. Tyco Thermal Controls LLC is turning to wireless sensors to cut down on the cost of laying wires in its pipe-heating systems. Such wiring accounts for two-thirds of the expense of installing monitoring systems. During the next three months, Tyco plans to launch customer tests.

As sensor systems grow more sophisticated, researchers hope to dispatch them on more complicated missions—and into our everyday lives. Intel is experimenting with systems in health-care centers to help patients with faulty memories—reminding them to eat a meal or drink water. No doubt, wonders like these in the home are still 7 to 10 years off. Still, the sensor revolution is off and running. While the last 50 years have been dominated by a march to ever more complex computers, the next few decades will see the rise of simple sensors—by the billions. ■

ERE, THERE, EVERYWHERE

y computers equipped with eyes, ears, chemical, and heat sensors are finding their way into every ok and cranny of our lives. Here's a sampling:

LOOK, NO WIRES ggles of sensors t are networked ether wirelessly monitoring oil d water pipelines d connecting ores of machines plants

SMART TAGS Tiny radio tags slapped on packages such as cases of Coke automatically relay their whereabouts to networks as they move from warehouse to store

WATCH OUT FOR THE BIRD! Hundreds of wireless sensors in hard-to-reach spots like bird nests on distant islands can glean insights into weather changes and wildlife behavior

VIRTUAL WATCHMAN Sensors placed on air-conditioning units track how the units are working and automatically send alerts to repairmen when problems develop

PEACE OF MIND Intel is conducting trials in health-care centers with sensors on chairs, beds, and kitchen cabinets that keep tabs on the elderly and people with memory loss

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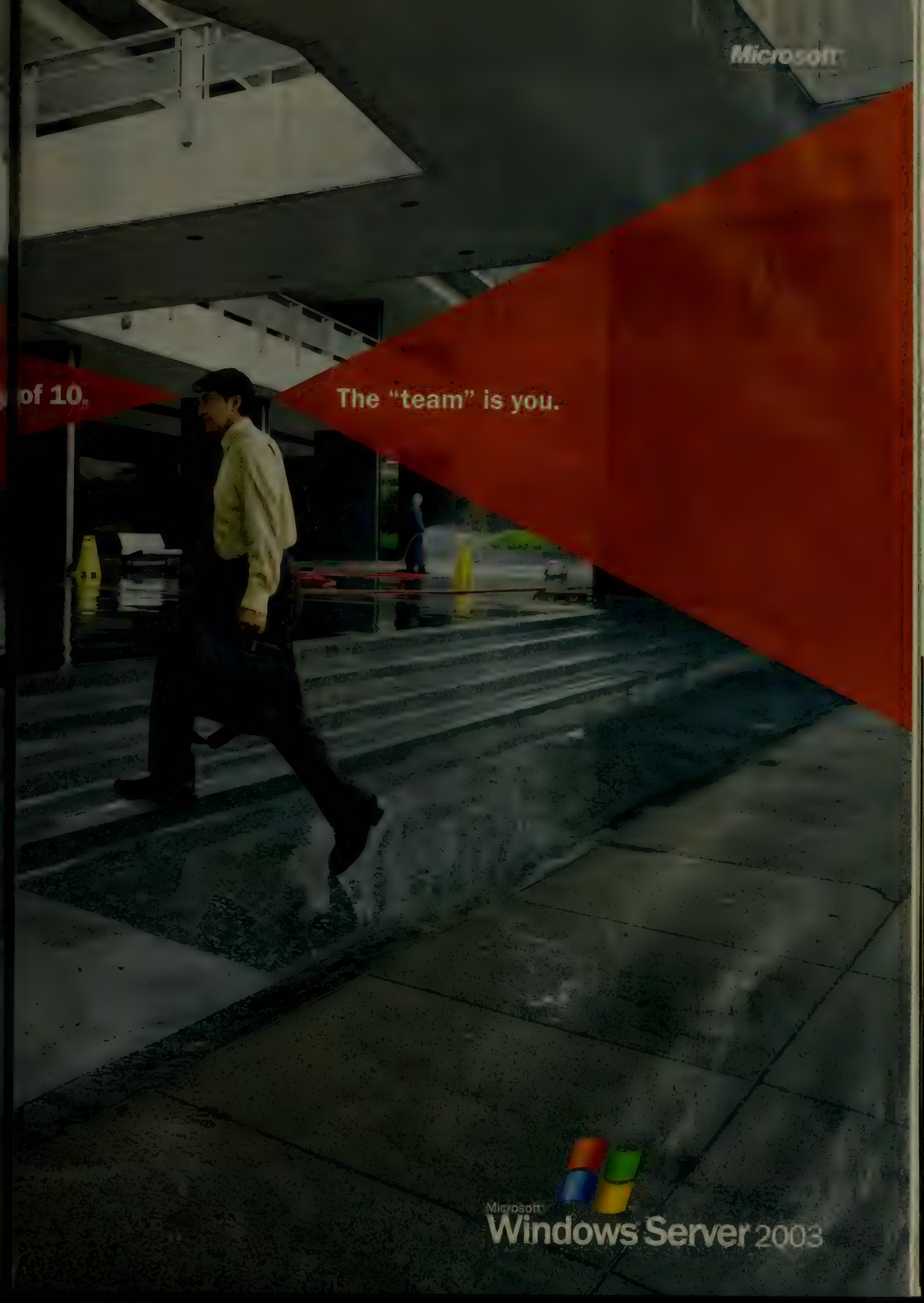
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3 PLASTIC ELECTRONICS

CHEAP, PLIABLE, AND POWERFUL

Next to innovative plastics, silicon could soon look clunky and dated

By Otis Port

It may be Hollywood's most famous one-word line: "Plastics." Since Dustin Hoffman's character ignored that career advice in the 1967 hit *The Graduate*, plastics have become the most prevalent material in offices and homes. And now, plastics are set to pull off a sequel—in electronics. Don't look for plastic chips to be used for heavy-duty computing chores anytime soon, but they could rival silicon sometime in the 2010s.

Until then, researchers worldwide see major new opportunities for information technology in this cheap and pliable alternative to silicon. Their targets range from wall-size television displays to ultra-tiny transistors. That sweeping potential has captivated some heavyweight companies in computers and consumer electronics.

Today, the movement is just getting in gear. An innovative plastic screen was unveiled this year on a digital camera from Eastman Kodak Co., which in 1979 discovered the first organic light-emitting diodes (OLEDs). Unlike the liquid-crystal displays (LCDs) in cell phones and laptops, plastic OLEDs don't break when dropped. And while LCDs require a separate light source, OLEDs generate their own light, so they save energy, and "colors are more vibrant," says James J. O'Brien, Dow Chemical Co.'s technical director for displays.

Dow has teamed up with Motorola Inc. and Xerox Corp. to develop polymer inks and printing methods that could spew out plastic circuitry like so much newspaper. That might one day lead to video wallpaper studded with millions of light-emitting specks of plastic. So walls could turn into TV sets or change color to match the season. DuPont Co. has similar ambitions and is working with Universal Display, Sarnoff, and Lucent Technologies. "Wall-size displays are going to happen—perhaps within five years," says Ananth Dodabalapur, an electrical engineer at the University of Texas.

Portable computers with OLED screens from Sony Corp., Sanyo Electric Inc., and others should show up in stores next year. And in May, Toshiba Corp. and Matsushita Electric Industrial Corp. unveiled 17-inch monitors with screens printed by squirting pol mer inks from special i jet printers.

Inkjet systems and o er printing techniques now heading down the path blazed by sili chipmaking equipment—producing ever-sma plastic circuit lines and transistors. How t can they get? Arthur J. Epstein, head of O State University's Center for Materials Resea says conducting plastics may eventually turn dividual electrons into transistors. The direct of an electron's spin, which can be control magnetically, would determine whether it's o off—or storing a one or a zero. As with polyr displays, tiny circuits of this type could be pri ed by special inkjets.

Not everyone buys into this idea. Greg Blonder, former head of materials research at old AT&T Bell Laboratories and now a vent capitalist at Morgenthaler Ventures, is betting molecular-size transistors such as the benze and-hydrogen molecule concocted last year Hewlett-Packard Laboratories. "Nature co putes with molecules," he explains. Either w commercial versions of ultra-small plastic ch may be a decade down the road.

On the other hand, plastic chips seem just ticket for jobs that don't require superfast p cessing, such as "smart" tags on manufactu items (page 100). These chips could also be guts of "ubiquitous computing"—giving virtu everything in homes and offices a wireless link a local network or the Web. Then milk contain could tell the refrigerator when they are runn low, so the fridge could post a note on its co screen. No wonder chipmakers such as Infine IBM, and Philips are more than just nostal about *The Graduate*.

Glowing Unlike LCDs, OLEDs are their own light source

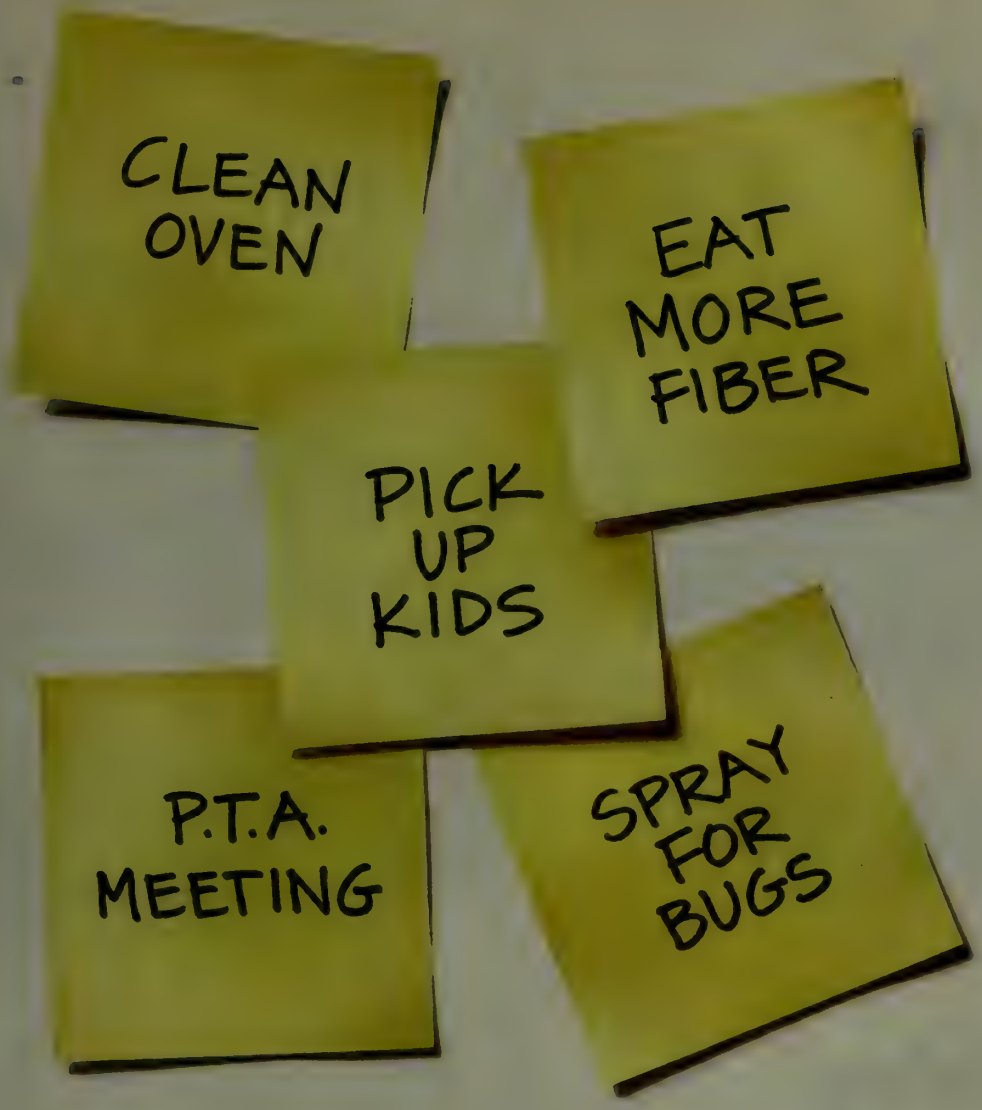
WHY THE FUTURE IS IN PLASTICS

DISPLAYS

- can be paper-thin
- have brighter colors than liquid-crystal displays
- are produced cheaply with inkjet printers
- are flexible, so they won't break when dropped

CHIPS

- may eventually offer compelling economics
- could replace bar codes on all goods in supermarkets



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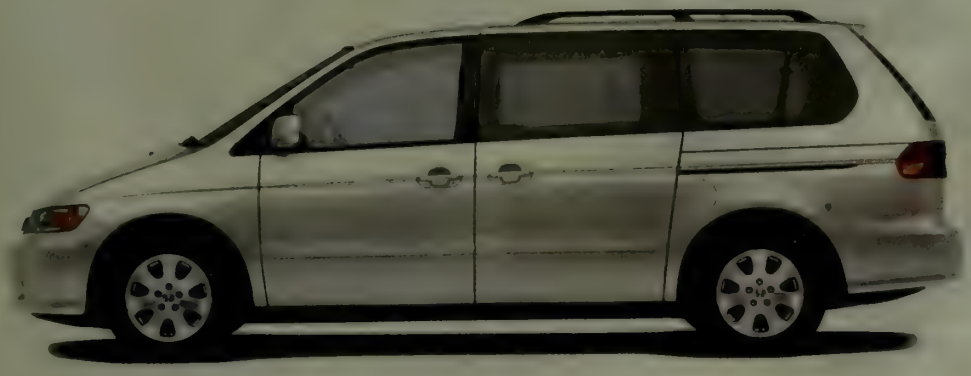

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4 BIONIC BODIES

OFF-THE-SHELF BODY PARTS

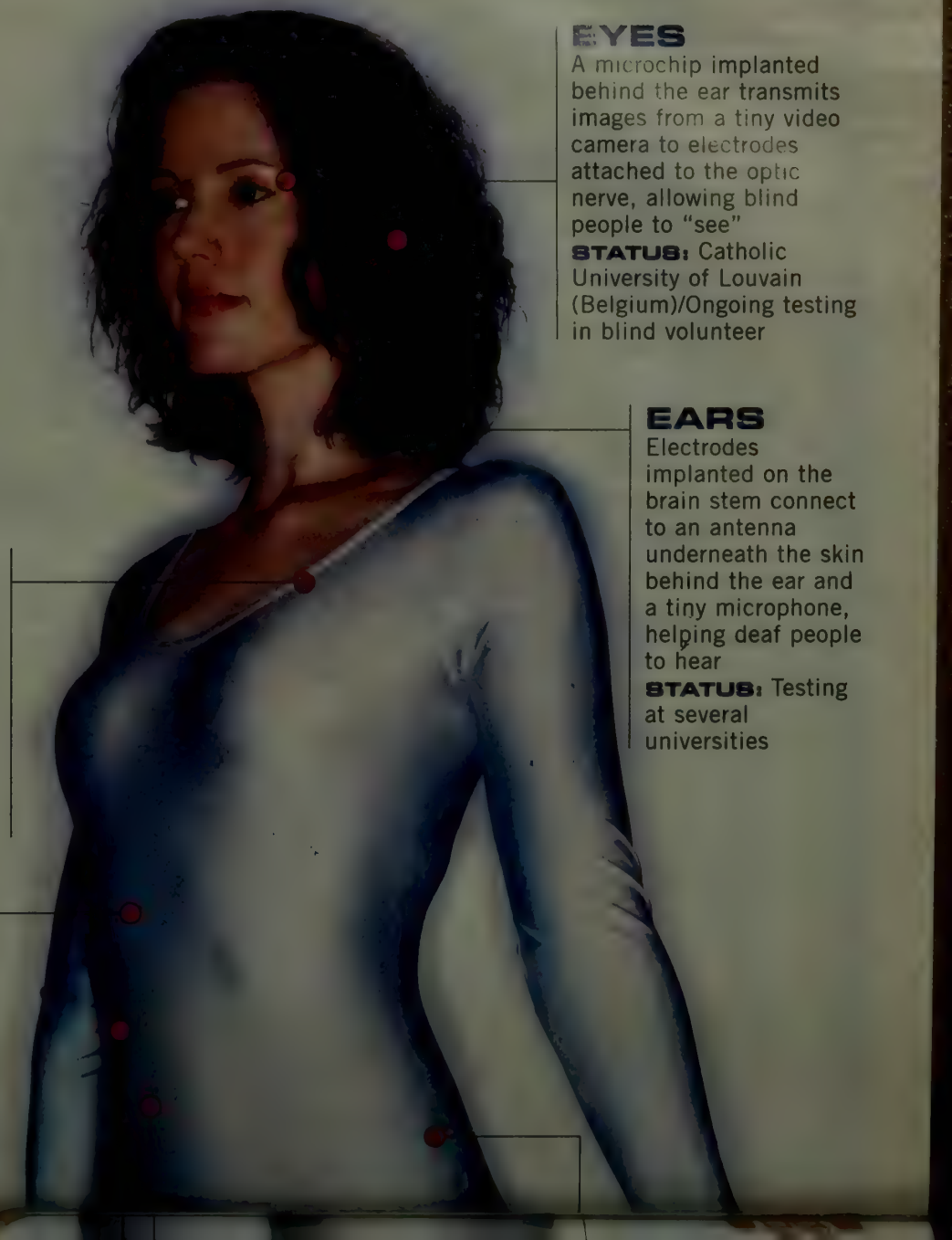
Marrying electronics and biology promises new devices that could transform millions of lives

By Catherine Arnst

The world is entering an age of bionic miracles. Consider eight people in Germany who suffered catastrophic liver failure, usually a death sentence. Early this year, these patients entered a clinical trial for a first-of-its-kind bionic liver—a tiny pump, a chamber containing human liver cells, and a catheter connecting it all to the patient. The cells organize themselves into a mini-liver that cleans the patient's blood much like the natural organ. All eight patients were kept alive until they received donor livers.

This complex device, developed by University of

id advances in component technologies, a patient might be sent home with one of these "bioartificial" tissues in



EYES
A microchip implanted behind the ear transmits images from a tiny video camera to electrodes attached to the optic nerve, allowing blind people to "see"
STATUS: Catholic University of Louvain (Belgium)/Ongoing testing in blind volunteer

EARS
Electrodes implanted on the brain stem connect to an antenna underneath the skin behind the ear and a tiny microphone, helping deaf people to hear
STATUS: Testing at several universities

HEART
Cardiac tissue grown in bioreactors for use in repairing damaged hearts and testing new drugs
STATUS: Massachusetts Institute of Technology/Very early development

LUNGS
Artificial lung made from a combination of polymers and lab-grown cells to serve as a bridge until damaged lungs can heal or be replaced
STATUS: ALung Technologies

...id advances in component technologies, a patient might be sent home with one of these "bioartificial" tissues in the next decade or so.

Right now, most bioartificial organs are meant as temporary solutions until the patient receives a human organ. Ultimately, scientists want to "grow" living tissue that will eliminate the need for a transplant. For that, "we want to design smart materials that can sense their environment and adapt," says Allan J. Russell, director of the University of Pittsburgh's McGowan Institute for Regenerative Medicine. Bionic devices already available are halfway to Russell's goal. The Dobelle Institute in Lisbon, Portugal, has developed a pair of glasses that combine a tiny video camera, a handheld computer, and a grid of electrodes embedded in the part of the brain that processes visual images. Also available is an artificial larynx. Implanted in the mouth, it uses chips and radio signals to translate movements of the tongue and lips into words amplified on a speaker.

But the cutting edge in replacement body parts are devices that incorporate living human cells. A bioartificial kidney, developed by Dr. H. David Humes of the University of Michigan Medical School in Ann Arbor, uses a plastic cartridge containing millions of human kidney cells to replace dialysis. Tested on 10 people with acute renal failure, Humes's kidney saved the lives of six.

Such hybrid devices are born from an unusual multidisciplinary mix, drawing on chemical engineers, computer scientists, biologists, and physicians. This has led to some unique approaches. Bioengineers Vladimir Mironov of the Medical University of South Carolina and Thomas Boland of Clemson University have "printed," layer by layer, a three-dimensional sheet of living tissue using standard inkjet printers. The ink is replaced with a cell solution, and the paper with a biodegradable gel. Such blends of high and low technology could end up transforming how we define life. ■

PHOTOGRAPH BY DENNIS CHALKIN

PANCREAS
Porous silicone nanomolecules contain insulin-producing pancreatic cells for the treatment of diabetes
STATUS: IMEDD (Columbus, Ohio)/Tested in rats

LIVER External bioartificial liver made up of a bioreactor containing human liver cells, attached via a catheter, to keep patients alive until a human liver donor is found
STATUS: Hybrid-Organ (Berlin)/Early human trials

KIDNEY
A plastic cartridge filled with human kidney cells replaces dialysis and pulls patients back from acute kidney failure
STATUS: Nephros Therapeutics (Lincoln, R.I.)/Early human trials

LIMBS
A bionic leg uses sensors in the amputee's shoes to send signals to an electronic memory, where a mathematical model reproduces the appropriate walking pattern
STATUS: Victhom Human Bionics (Saint-Augustin-de-Desmaures, Quebec)/In production

SPEAKING OUT: THE VIE

BW asks techdom's heaviest hitters to weigh in on the future of innovation, economic advantage, and more

BILL GATES

Microsoft

What shape will the tech recovery take?

If anybody thinks we're going back to where we were in the late '90s, they're wrong. That level of spending just isn't going to happen. There's general growth in the economy. There's a move to use technology to empower workers better. There's a move toward vendors that really offer comprehensive solutions. So there are a lot of interesting trends that mean there's some growth for companies like Microsoft. But it doesn't mean some return. The period we're in right now is more normal than the period we were in then.

Does that suggest the tech industry is mature?

The impact of technology is going to continue to be very dramatic. The cost of computation, and the cost of what you get in terms of the value of software, are going down at an incredible rate. So there are many scenarios that were never possible before, including some that got hyped up during the bubble, that actually become realistic. Most of the breakthroughs—efficiency of e-commerce, collaboration—are still in front of us.

Does Microsoft's decision to issue a divider hand out restricted stock instead of options it's a mature, slow-growth company?

No. Obviously we're a bigger company than we were 25 years ago. In terms centage growth, we had a lot of years year after year we grew 60%. We're not up. If people are just recognizing that, it's strange. We are, on a relative basis, a ver ly valued company. But we only get rev we innovate. Just to be a large company forward, we have to do a lot of innovatio there's more innovation coming out of t that we'll do in the next five years than five-year period in the history of the co

What will be the big areas of growth?

Look at business intelligence, workfl laboration, real-time communication: We scratched the surface. How do you m those back-end systems easy to manage cure? How do you make it easy to wri service applications that cut across the aries, inside a company and between com Now that we have all this Internet conn how can buying and selling and planning differently? That's an unrealized dream. O lenge is to make those dramatically sim

ROM THE TOP

CHAEL DELL

h industry mature?
olution of technology is showing of maturing whatsoever. If you anomaterials or photonics, car- tubes, all the things that are in new types of energy, envi- lly better materials—there's no of new technology coming. IT is near maturity. Certainly, there's ion among business models and rs, but it doesn't have the tell- of a mature industry where innovation.

What's your take on Nick Carr's thesis that technology no longer gives corporate buyers a competitive advantage?

Just about anything in business can be either a sinkhole or a competitive advantage if you do it really, really bad or you do it really, really well. And information technology is an often misunderstood field. You've got a lot of people who don't know what they're doing and don't do it very well. For us, IT is a huge advantage. For Wal-Mart, GE, and many other companies, technology is a huge advantage and will continue to be. Does that mean that you just pour money in and gold comes out? No, you can screw it up really bad.

◀ CARLY FIORINA

Hewlett-Packard

How is innovation changing?

In the 1990s, innovation was really focused around killer apps, hot boxes. Technology was seen as a stand-alone, silver-bullet answer to a lot of problems. Technology isn't a silver bullet. The innovation that is going to be most important is what I call innovation around fundamental capabilities and fundamental fabrics—the kinds of innovation that weave systems and networks together. Security, mobility, rich media would be examples. These require systems approaches. They also require scope and scale, which is why we have been so convinced that the industry will consolidate into fewer, bigger players.

Is the tech recovery centered on companies making better use of the gear they have vs. buying the latest and greatest?

Companies are realizing that they are not getting sufficient return out of the IT investment they've already made. So a lot of them are focusing on: How do I increase my return before I start again? That's one of the reasons I've said that technology is going to grow at two times GDP, not five times GDP.

What's the outcome if IT grows at two times GDP?

It means not everybody survives. This could still be a great industry. Two-times GDP is not bad. And if you're Hewlett-Packard, a $73 billion company operating in 167 countries, we think that's a pretty great industry to be in. But it does mean that because customer requirements are increasing, not everybody can get over the bar. So there will be fewer winners.

What are the roadblocks to a full-throttle tech recovery?

The general health of the economy is a huge deal. It takes confidence for people to make capital investments. Beyond that, the fact that people must spend real dollars on technology is as inevitable as the sun rising.

▶ STEVE JOBS

Apple Computer, Pixar

Many tech companies have cut R&D spending because they believe the industry is slowing down. You haven't. Why?

What has happened in technology over the last few years has been about the downturn, not the future of technology. A lot of companies have chosen to downsize, and maybe that was the right thing for them. We chose a different path. Our belief was that if we kept putting great products in front of [customers], they would continue to open their wallets. And that's what we've done. We've been turning out more new products than ever before, and Apple is one of only two companies making money in the PC business.

Where has Apple been innovative?

Look at the iPod [digital music player]. We sold over 300,000 iPods last quarter. Just to put that in perspective, we sold about 750,000 overall units—so if you look at each of those iPods as a $400 computer, that's a 40% increase in our volume. And it's a whole new product category.

Are you concerned that your peers lack fresh ideas?

I look around, and I'm pretty stunned at how many successful young companies I see. I look at eBay and I'm amazed. I look at Google and I'm amazed. Th some pretty good companies in the and they're not just one-product comp they're real companies. They're already than some of the great entrepreneurial nies of the past. So I think a lot of pe miscalibrated because of the Internet b

The rate of innovation now is not cantly different from what I've seen last 20 years, if you take out the Intern ness. I see a recovery in innovation con of this downturn. I see some very stro panies that have been built even in the tough times. And I see some new spro ping up out of universities. I'm an opti

Apple has had early success working with music industry to create its online music iTunes. Do you think the music industry rect in taking legal action against its customers who pira over the Internet?

Stealing music is not right, and I can understand being very upset about their intellectual property being But the stick alone isn't going to work. So we're work better product.

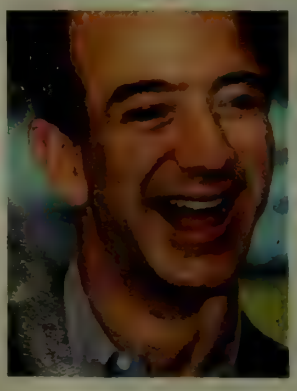
The music industry is based on selling unprotected can be read on CD players that are as dumb as a rock [detect pirated music]. The right solution is to compete Kazaas [music sharing services] of the world and to be And that's what we're trying to make happen.

▼ JEFF BEZOS

Amazon.com

At what stage is the Internet as a technology?

It's like the early days of electrical appliances. The Internet and the things that will come out of it are around the level of the 1908 Hurley washing machine. The electric outlet had not been invented yet. Nor had the on-off switch.



What new technology most excites you these days?

One thing is all the stuff going on in the unlicensed spectrum, the most famous being Wi-Fi. You'll be able to be wirelessly connected the whole time. Anything that lets people be connected more easily to the Internet is great for us.

What about space travel? You have bankrolled a space startup.

I'm funding a very early-stage space research company called Blue Origin. We want to try to make it safer and lower-cost for people to go into space. We will be but a small part of a big, challenging, hard technical effort.

Can Amazon keep getting an edge from technology?

By building new technologies ourselves, we get to offer a better customer experience. Does that give us an advantage? Absolutely. Now, if we just rest on our laurels, we're not going to enjoy that advantage. You have to continue to innovate.

▲ JEFF IMMELT

General Electric

How important is technology to GE?

It's a business imperative. We're primarily a ser ented company, and the lifeblood for productivity about tech than it is about investing in plants and equ We tend to get a 20% return on tech investments, tend to invest about $2.5 billion to $3 billion a year.

What kind of technology will be key in the future?

Wireless could have a huge impact. We have an in amount of people who work close to the customer—ou people, our service people. Making them more produ my No. 1 priority. Wireless is going to be the key to

(CLOCKWISE FROM UPPER LEFT) MARIO TAMA/GETTY IMAGES; JEFF GEISSLER/BLOOMBERG NEWS; THOMAS BROENING; CHRIS HONDROS/GETTY IMAGES; JOHN FROSCHAUER/BLOOMBERG NEWS

AM PALMISANO

the lessons learned from the bust that will be applied covery and any future boom?

iggest lesson is that the customer is now in charge. itnessing a major power shift between IT and the rest ess. From now on, the tech companies that succeed hose that have developed skills at listening and a so- ed understanding of their customers' industries.

get me wrong: Technology is still important. IBM isn't g billions of dollars every year in R&D—and winning tents than our top 10 competitors combined for more ecade—as an academic exercise. But research is now iven much more by what people need rather than just is possible.

e impact of consolidation on startups and innovation?

ave one concern, not about industry consolidation but ossible overreaction to recent corporate excesses. nderstand, I think it's entirely fair for society to im- ropriate oversight, particularly for companies of IBM's reach. But when you're a 30-person startup, you have the resources for everything that is being con- d. If we overregulate, overcontrol, impose too many and too much bureaucracy, that could make people se and dampen the entrepreneurial spirit.

t could also knock out of whack a very delicate m—among venture capitalists, entrepreneurs, aca- nd industry—that has for decades created enormous n and economic growth. We understand the impor- improving governance, but we need the right balance.

next stage of the Internet be led by the U.S.?

.S. still has an unmatched IT ecosystem, not to men- tional propensity to innovate. There's a strong com- to technical leadership by the U.S. government. l, innovation is not an American birthright, and to try e it that way ignores the realities of global compe- everything from customers to ideas.

moving beyond "international" business to some- t is more like "transnational." For instance, IBM has are labs around the world. We're global by definition, eates tremendous advantages for our customers and ders and opportunities for top talent [globally].

▼ JOHN CHAMBERS

Cisco

How bright is the future for tech?

I am an optimist about the future of tech, and I am because of the role it's going to play in terms of our standard of living and productivity. There's wave after wave of applications and new technologies that are going to change fundamental business processes, in ways that people are just starting to imagine. The virtual networked organization will be the most basic change since the assembly line—except it won't only be for manufacturing, it will apply to all businesses and governments.

Do you expect tech will keep delivering big productivity gains?

We're at the early stages of what this productivity can mean. Over five years ago, we said it was possible for a country to grow 2% to 3% a year, and that 3% to 5% was not out of the question. The top economic thinkers and business and government leaders politely said: "The concept is nice, but not a chance." But we knew we could drive our own productivity 10% a year—and then use that productivity to move into new markets, or to bring it to the bottom line.

Now most people think 2% to 3% growth is a given. But stopping at 2% to 3% would be a huge mistake. I think we could grow 3% to 5% [and benefit from] the huge standard-of-living implications that go with that.

When did you start preparing for an upturn?

We started 2½ years ago. The time you make the changes is before anyone else sees it. There are a lot of advantages to being near a herd, because a herd has 1,000 eyes. But if you're not moving well in advance of the herd, you're in line with the herd's achievements.

How will this recovery be different from the last one?

In the 1990s the race was run by constantly driving over 200 mph. Anyone who tapped on the brakes was left behind. Today, it's more like the Tour de France. There's times when you're sprinting, there's times you're in huge turns, there's times when you're going uphill.

MARC ANDREESSEN

Opsware

Do you agree with Larry Ellison that Silicon Valley, as we know it, is dead?

Of course not. Larry's a brilliant guy. That said, everything he says has to be filtered through his own self-interest. And you have to take everything with a massive grain of salt—a boulder of salt. Larry says things like, "The PC is dead. The Network Computer is going to take over." He says things like: "Internet television is going to be huge." All these things Larry said over the years that weren't true, they're all self-interest.

So in this case, he's got a very interesting situation on his hands. He's got a very large software company where the core franchise, the database business, is a very good business. But he's got big competitors: Microsoft and IBM and now open source. There are some very interesting questions around the future of that business. And he's got a big consulting business, which is fine, but big consulting businesses are hard to differentiate because they all do basically the same thing. And then he's got this applications business that he hasn't really been able to get traction in.

Have you seen the Next Big Thing?

Nope. Almost by definition, I won't. When it first emerges, it's likely to look deeply fringe. The people who are involved in the next big cosmic thing probably can't even get a job at Opsware because they're too fringe to work at an established software company.

(CLOCKWISE FROM TOP LEFT) MARK RICHARDS; TOM WAGNER/CORBIS; NICOLAS KHAYAT/KRT; JUSTIN SULLIVAN/GETTY IMAGES; ROBERT HOUSER; RANDI LYNN BEACH/BLOOMBERG NEWS

JOE KRA

Entrepreneu

Is it harder launching up today than when y founded Excite in 19

This is a great start a company. boom years, a sense tlement pervaded Sili ley. That attitude is g stead, you're hiring who are doing start cause they love sm panies. Second, you people who have done their jobs befo couldn't do that in th

What is the greatest threat to a tech recovery right now

One is that there has been a runup in consumer stocks, be it eBay, Amazon, or Yahoo! Those are defini businesses. But the runup seems to be without adeq planation. If those were to fall back, maybe that defl psychological element of this recovery. Second, I st venture-capital funds are overfunded. These funds can all of their money and have high quality [investment either means they'll lower their quality—and that damaging—or it means limited partners aren't goin the returns they want, which is the more likely outc

PAUL SAFFO

Institute For The Future

What's the next technology revolution?

About every decade, a new technology comes in ar the landscape. The current decade is being shaped b sensors that connect our devices to the world arc We're right in the middle of the sensor revolution ta In 10 years you're going to walk into a room and everything has rudimentary intelligence. People w their vacuums names because they'll act like living thi ply this to engines. With sensors, the engine can when it needs to be fixed. The ramifications are brea

Are there any obstacles to innovation?

We've got a couple of gorillas holding back innovation. Microsoft is a big intellectual roach motel. All the big minds go in, and they don't come out.

Is there any hope for startups today?

What did the dinosaurs do before they went extinct? They got really big.

ASAYOSHI SON

ebank

n the U.S. learn from Asia's boom in d?

United States has to wake up. The speed of broadband in the U.S. is ntieth of [the speed in] Japan. This is the development of software and d technology. The U.S. government ake up and increase competition.

chnologies are most likely to change we work and live?

band.

on Valley play a role in the coming and what will it be?

nerica, yes, but not in the world. efinitely is the center of broadband, n is going to become a center very The U.S. is falling behind. For the duction of electronic goods, China is g the new center of the world. They me the producer of the world and more innovative along the way.

OTT McNEALY AND BILL JOY

Microsystems

n Silicon Valley rebound with the rest of tech?

g about the future of Silicon Valley isn't really my too busy talking to customers about creating new gy to help engineer complexity out of systems. But ut it, that is what Silicon Valley is all about—pure in- not bound by geography. barriers are the ones we So it's time to stop talk- start doing. Time to start ing to address the mam- stems that have taken part of the universe.

tems are you referring to?

elief is that everything nected to the network. ates a massively complex and our whole deal is ving complex networking s. That creates a $2 bil- challenge for us.

e overarching challenge facing tech?

my belief: Our industry spends all of its time buying reed, state-of-the-art, little tiny components, as op- buying the car or the airplane. So we go out and buy ng gear, the avionics, the wing flaps, the tail rudders, n a different vendor. And then we hire an army of peo- to build a custom airplane. If you look around our in- o two airplanes are alike. It is unbelievably screwed up. 're trying to do is engineer that problem away.

Bill, at Davos recently, you asked: "What if people have already bought all they need?" That doesn't bode well for tech.

Who do you know who doesn't already have a DVD player? My point was, is there enough stuff? Many of the people with disposable income may have more than they can take care of. And there is not much out there to inspire you to buy.

So where will the industry's growth come from?

The real growth area is in the different kinds of devices we focused on a decade ago with Java: mobile devices, cellular phones, wireless devices.

What do you think of the advanced research coming out of universities today?

Frankly, for the past 20 years, the universities have not been as far ahead as I would have liked. What they are doing is barely research. There were years where Bell Labs and Xerox were doing the innovative stuff. And once that stuff got commercialized, the universities weren't doing stuff that was as radical as it should have been. It's a little ossified.

Can private sector investment make up the difference?

The IT sector is large enough that the R&D going on there can make up much of the difference in applied technologies. But for some work—like breaking the physical laws, like quantum computing work that has no foreseeable payoff—you need a long-term project for that. That needs to come out of research institutions. It's not as likely to come out of industry research. ■

WHERE DANGER LURKS

Spam, complexity, and piracy could hinder tech's recovery

By Stephen Baker

Turn down the music. Put the Veuve Clicquot on ice. The party could be delayed. You're the skeptical sort, right? The type who looks for rust on the underbelly of a shiny Corvette. Now you're reading about the glittering future of technology, and you may well be thinking instead about the cell phone that drops calls and the printer that stalls just when the kids' papers are due. It's enough to make you doubt.

The tech world can be a bewildering place. Machines freeze and crash. They come with thick manuals that, for English speakers, might as well be in Pig Latin. Far worse, the Internet has dark alleyways filled with thieves, hackers, and scamps—and the industry hasn't found a way to cordon off their mean streets. Earlier this year, the Pew Research Center surveyed the 42% of Americans who are not yet on the Internet and asked them why they w holding back. Expense and confounding tech ogy discouraged some. Even greater numb feared barrages of online pornography and tacks by credit-card thieves.

If these issues aren't resolved, they co prove formidable roadblocks to a strong te nology recovery. Sure, the industry could tur deaf ear to the complaints and still expand single-digit rate. But a strong turnaround hin upon far more than gaining the grudging supp of the grin-and-bear-it crowd. Whether tech ogy regains its momentum depends, in la

on how the industry tackles these thorny
ms.

M

up in the morning, turn on the PC, pour a
coffee, and before the first sip, you're
face with everything that's ugly, scary,
st plain wrong about the Internet: spam.
er the globe, spammers are churning out
-mail, many of them sending tens of mil-
f messages a day. Spam accounts for 50%
ernet traffic and is on track to deliver
than 1,000 mailings this year for every man, woman, and child on the Net. This not only clogs everyone's in-box but also slows down the Net and jams servers around the globe.

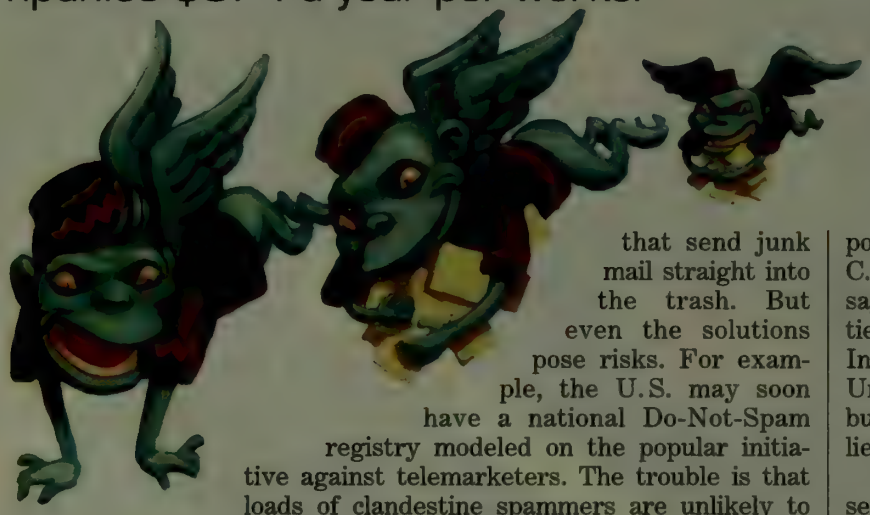
Spam weighs down productivity. Companies have to buy more hardware to handle the avalanche of mail, and workers are wasting precious time every day combing through unwanted messages. Nucleus Research Inc. in Wellesley, Mass., calculates that spam costs companies $874 a year for every worker with e-mail.

It also undermines e-commerce. Spammers often hide behind the names of real companies. Sometimes they even direct unwitting customers

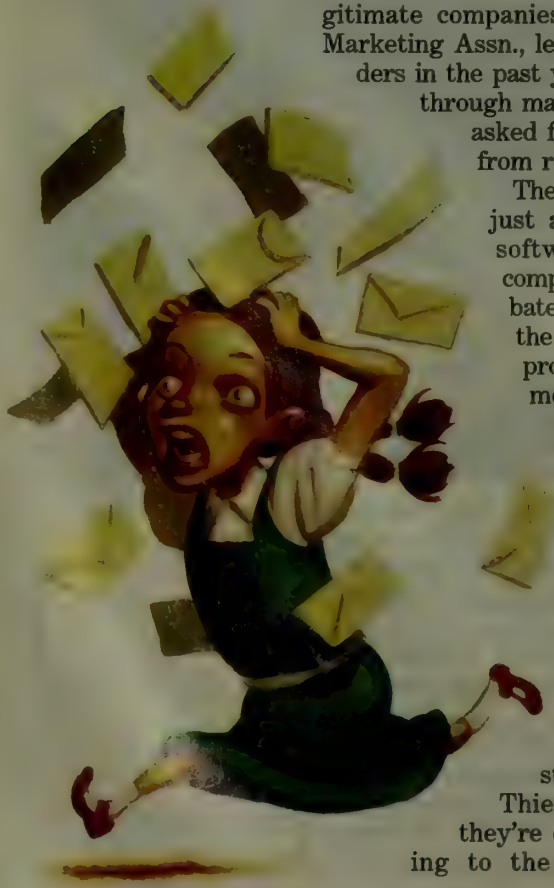
to facsimiles of real companies' Web sites, including retailer Best Buy, Wells Fargo, and eBay. The goal: to coax credit-card numbers from the victims. Few people report falling for the trick, says the FBI. Yet even those who sidestep danger come away with the message that the Net, teeming with grifters, is a risky place to shop. That message—poisonous for tech—gets reinforced when they purge their spam every day.

Solutions? There are plenty of them, from new legislation to outlaw false headers on e-mail messages to spam-blocking technologies

The avalanche of spam may be costing companies $874 a year per worker



that send junk mail straight into the trash. But even the solutions pose risks. For example, the U.S. may soon have a national Do-Not-Spam registry modeled on the popular initiative against telemarketers. The trouble is that loads of clandestine spammers are unlikely to heed the law. And the measure could wallop legitimate companies. According to the Direct Marketing Assn., legit outfits have received orders in the past year worth at least $2 billion through marketing e-mails that weren't asked for, and a further $5.7 billion from requested e-mail.



The onus is on techdom. It's not just a matter of building better software to block spam. Tech companies must also lead the debate, helping steer Congress and the public along a path that will protect e-mail and keep e-commerce safe—without sacrificing the efficiency of one of the industry's treasures, electronic mail.

INSECURITY

Two types of villains prowl through the open doors and windows of cyberspace: vandals and thieves. Vandals deface Web sites and set loose a steady stream of destructive worms and viruses. Thieves steal and extort. And they're on a roll. Last year, according to the FBI, reports of Internet fraud—from e-commerce scams to iden theft—tripled, to 48,000, in the U.S. Repo damages climbed to $54 million, but the tally is presumed to be far greater. FBI Dire Robert S. Mueller III estimates that tw every three fraud cases go unreported. An has listed cybercrime as the FBI's third-r ing priority, behind only the war against te and counter-espionage.

Even powerful companies are proving vul able. Early this year, a software worm laun by a vandal infected the systems at Ban America, bringing down 13,000 automated t machines. Weeks later, a hacker broke thro the security system at Data Processors I national Inc., an Omaha credit-card proce and made off with account information up to 8 million cards. Such thieves, says Murray, a spokesman for the FBI's cybe vision, often sell stolen credit-card numb on black-market Web sites for $1 api "They put up the sites for a day, do t business, and then disappear," says Mur

Lots of software flaws, or bugs, pro ports of entry for thieves and vandals. Cha C. Palmer, head of IBM's computer-security says that roughly six new software vulner ties are reported each day to CERT, a center Internet security expertise at Carnegie Me University that compiles industrywide stat bugs and hacker attacks. By 2005, Palmer lieves, the number could swell to 64 a day.

Technology leaders are starting to gra seriously with security. A year ago, Micro Corp. Chairman William H. Gates III annou a "trustworthy computing" drive. He shut d much of software development for 10 week that employees could take security-trai courses. And Microsoft's next operating sys code-named Longhorn, should have far stur defenses than Windows when it's released year. Steven M. Bellovin, top network-secu maven at AT&T Labs Research, says he's pressed with some of Microsoft's security forts, but cautions that they will take yea develop and be deployed.

Even with secure systems, users can cr plenty of vulnerability. They routinely log o corporate networks through undefended h computers. Worse, the most common passw is ... PASSWORD.

To create systems safe enough to host muc the world's economy, tech companies must b in bullet-proof security from the get-go— convince the public to lock their computer firmly as they bolt their front doors.

SQUEEZED BROADBAND

Who most enjoys a fat broadband conne to the Internet? That's easy. The people download massive music and film files from Web, most of it pirated. Sadly, the legal offer for broadband, from streaming video to Inte radio, are not nearly as compelling. That's reason the migration to speedy connection

.S. has been slow: Dial-up con-
ns work fine for the No. 1 Internet
ation, e-mail. But this delay has a
Brookings Institution economist
t Crandall estimates that rapid
ment of broadband could generate
eds of billions of dollars in new
ess, spurring everything from
mmuting to digital entertainment.
nds strange, but one reason
band doesn't grow big is that it's
rned small. Even after growth of
ast year, only 19.9 million U.S.
nolds—17% of the total—subscribe
adband, says researcher RHK Inc.
ize discourages marketers from
ping great broadband program-
and services. The long-awaited
ion of rich new offerings isn't like-
take place until the broadband
tion accounts for half of the 60
Web households. That, say ana-
is when the scales will tip, and
et will finally become a broad-
medium.

U.S. comes late to the game.
and South Korea already have
igh-speed connections, averaging
nes the speed of broadband in the U.S.
fiber-to-the-home networks are something
U.S. companies, such as Verizon, are only
eginning to plan. "In broadband, we're al-
a Third World country," says C. Richard
ich, founding partner of venture firm New
prise Associates.

news isn't all bleak. Costs in the U.S. are
g down. Verizon and SBC Corp. are offering
band service for as little as $29.95 a month,
couple of cappuccinos more than a stan-
ial-up subscription. The upshot: The broad-
ipping point could arrive within two years.
and media companies quickly come up
maginative broadband programming, they
sten this migration to fat pipes—and po-
themselves as leaders in the next phase of
ternet.

CY

lywood's pain burns on. The music industry
d out the file-sharing phenomenon Nap-
with a legal barrage two years ago. But
promptly shifted to successor sites such as
A and Morpheus. This piracy pummels CD
which are expected to fall by 5% to 8%
ear, after an 8% drop in 2003. And even in
e of threatened lawsuits from Hollywood,
appers are moving quickly to video, down-
g about half a million movies a day, ac-
g to entertainment-industry estimates.
danger for the tech industry is that Hol-
d, in its zeal to defend its business, will
war on digital entertainment. Early shots
nging. The music and movie studios are
ng to file suits against hundreds of indi-
downloaders. This has prompted a July 30

Every day technology comes up with new ways to track our every movement

lawsuit by SBC against the Recording Industry Association of America charging that the subpoenas of its customers are unconstitutional. Hollywood lobbyists meanwhile are pressing for stringent laws that would wrap their products in enough legal and technological armor, many fret, to make them unappealing.

For digital entertainment to flourish, the tech industry must respond to Hollywood's fears. This means coming up with innovations that satisfy a generation of Napsterized downloaders while ensuring that the studios' property is safe.

Signs of progress are popping up. Apple Computer Inc.'s iTunes service, released in April, gives customers much of the freedom and selection they want. It lets them buy songs for 99¢ each and copy them to as many as three other computers or music players. Even Napster founder Shawn Fanning is proposing solutions. His latest: a music clearinghouse that will automatically check copyrights on a song and charge a user for it. These are steps in the right direction. The key now is for tech and Hollywood to hammer out agreements on building sophisticated copy protection into the next generation of digital TVs, cable boxes, and personal video recorders.

INVASION OF PRIVACY

Camera-flashing paparazzi invade the privacy of celebrities but leave the rest of us alone. That could change. An estimated 37 million people this year will buy cell phones equipped with Internet connections and digital cameras. This means that all of us—not just celebrities—will be surrounded by legions of shutterbugs, even as we're showering at the gym. These pictures can

be zapped in a flash to the Web. No wonder the YMCA in Australia already has banned such phones on its facilities.

Every day, technology is coming up with new ways to track our movements. We leave electronic footprints on every Web page we visit. Online receipts, electronic orders, e-mails—none of it disappears.

This loss of privacy is giving birth to powerful resistance. A public uproar led the U.S. Congress last winter to suspend a Pentagon-driven surveillance program, dubbed Total Information Awareness, that had the scent of Big Brother. Similar protests pushed Italian fashion house Benetton Group to step back from a radio-based inventory tracking system. Consumers feared that the tags could be used to track people's movements and purchases.

Much of the privacy challenge boils down to openness, clear communications, and sharp limits. Instead of giving people a small, hidden choice to opt out of an information-sharing program, companies should limit participation to those who explicitly opt in—a privacy defense common in Europe. To cash in on the power of these new networks, tech companies and their customers must steer clear of even the appearance of a privacy infringement. Otherwise, they'll face fierce resistance, from Net bulletin boards to the corridors of Congress.

Too many gizmos are confoundingly complex and the barrage of jargon is evermore baffling

COMPLEXITY

Granted, it's a bit cruel, but it's also a wickedly effective test of design. To judge whether a PC, a Web service, or a cell phone lives up to its user-friendly billing, find a couple of septuagenarians and put them at the controls. More often than not, frustration will ensue.

The biggest challenge technology faces, says Massachusetts Institute of Technology professor Nicholas Negroponte, "is a consumer revolt against unreliable, difficult-to-use, and outright ugly products."

Inside companies, the complexity is daunting. Says Edward W. Felten, a computer science professor at Princeton University: "A corporate computer system is one of the most complex things humans have ever built." The tech dustry's answer is to build even more com systems, but ones that are smart enoug manage themselves. IBM, Hewlett-Packard and others are betting big on so-called ut computing (page 96) which would permit tomers to tap into computing resources as si as they turn on electricity or water. It's a f lous dream, but one likely to take the best of a decade as companies stitch together a ta of systems—and iron out security concerns.

Complexity may well be a greater problem the public. The latest fad—some call it the ital Home—beckons consumers to fashion h radio networks in their houses, linking com ers, handhelds, stereos, digital TVs, even re erators. This involves a host of machines m by different manufacturers shuttling coun applications. To pull this off, the tech indu must settle on common standards, so that gadgets understand each other. Equally im tant, they must build systems simple eno for grandparents to assemble.

JARGON

"If you could spare a second, I'd like to you about an innovative suite of Java-ena Web-service solutions."

"You don't say."

"It's customized for the SME sector. P seamlessly right into your ERP backbone chitecture-agnostic. Backward-compatible your legacy doesn't come up and bite you."

"That could hurt."

"I'll say. And what about your front end"

"You tell me."

"We have an open-source CRM platform. W Web-enabled it, and it's massively scalable. W got a beta running on mobile clients. Shoul ready for 3G, two-point-five G, or 802.11b s tions by the end of Q4'03. Worst case: Q1'04

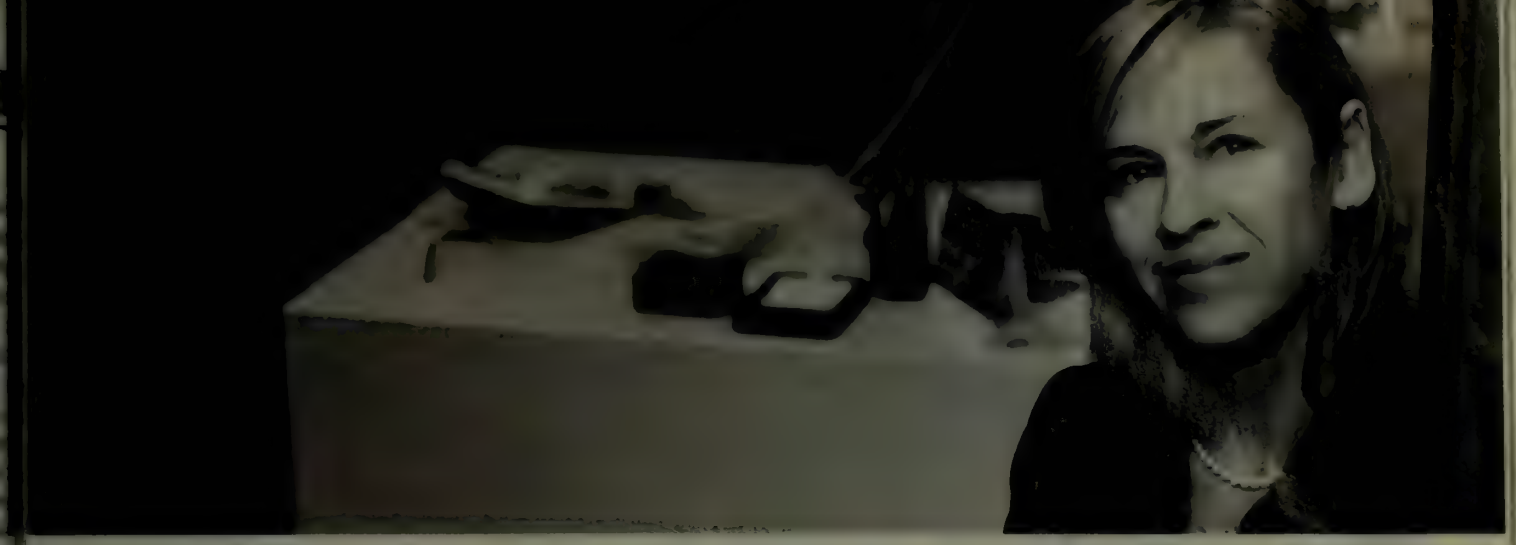
"Hmmm."

"You're probably wondering about p points...."

Tech jargon equals miserable communicat and it's a drag on sales. Jargon-spewing m keting execs pitch their products in w amounts to, for many listeners, a foreign di The industry spends $10 billion a year on vertising that befuddles potential customer recent survey by tech-research firm MetaF Inc. found that even computer buyers are cold by the language in ads. "Slightly more t half of the PC users we spoke with don't un stand the term 'megahertz'—which is used i vast majority of PC advertisements," says Pa Moorhead, vice-president for corporate mark at chipmaker Advanced Micro Devices Inc.

The solution is simple: clear English. In t speak, it's a concept platform to accelerate k cy removal. But for info tech to spread prosper, it's nothing less than essential.

Contributing: Heather Green, Ira Sager, Steve Rosenbush in New York, and And Park in Dallas



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LARRY ELLISON: THE OLD VALLEY IS HISTORY

Oracle Corp. CEO Lawrence J. Ellison has always been a provocateur. Whether it's trading barbs with his rivals at Microsoft Corp. or mocking Wall Street analysts enamored of Web startups, Ellison has never minced words. In a June interview with senior writer Steve Hamm and a July interview with Silicon Valley correspondent Jim Kerstetter, the software executive once again ruffled feathers with his take on the future of technology.

Why do you think the tech industry is mature?

There used to be hundreds of railroads in the U.S. And then there was a crash. And a lot of those railroads merged. Interestingly, after the mergers, the railroads were actually more efficient and delivered more value to their customers than they did during the go-go wild fantasy days of the railroad. The same thing was true in the automobile industry.

Let's think more recent. I remember sitting at dinner at my house with Michael Dell, trying to remember how many PC companies there used to be in the U.S. I remember saying: "Michael, there must have been at least 50 PC companies." Michael said: "Fifty? There were 500." The industry starts out with lots of startups, and then companies vanish, and there are a handful of winners. There's General Motors and Ford. There's Dell and HP. And I think there's going to be Oracle, Microsoft, SAP, and maybe IBM in enterprise software. There aren't going to be hundreds of enterprise software companies.

> There used to be hundreds of railroads in the U.S. And then there was a crash

Who will be the winners and the losers in this consolidation?

The largest companies win, and the small companies lose. Dell and Hewlett-Packard. Microsoft won in the PC software industry.

How will this affect innovation?

Innovation increases. Big companies do at least as good a job of innovating as little companies. Marc Andreessen said innovation was driven by 19-year-olds in startups. It's a very interesting perspective. It shows how young Marc is. Most of the innovation in our industry has been driven by fairly large companies. Take IBM. IBM invented the disk drive, core memory, and fractal geometry, for God's sa IBM has been a cornucopia of invention. An they stand in stark contrast to a much younger company, Microsoft, which has don no innovation at all.

What technologies are you excited about now?

We are the leader in bio-informatics, and lot of things there are exciting. Sure, Wi-Fi even 3G, is fairly cool, albeit expensive. Bu the thing I'm most interested in is software a service. That idea that every customer w wants to do accounting on computers, or e customer who wants to do inventory, or ma facturing, has to figure out what computer buy, what operating system to buy, what C router and switch to buy, what database to buy, is just nonsense.

Companies should be experts in their bu ness, and computing should be available on Net as a service. So more and more, our bu ness is changing from selling our applicatio to our customers to: We buy the computers we run the applications, and you use it. We be the experts. And you just pay us a mon fee. That really is utility computing.

You've been saying that Silicon Valley as we k it is dead. What do you mean by that?

The idea that Silicon Valley is going to c back and be anything like it was in the pas with hundreds and thousands of startups, t Silicon Valley of old where people talk abo deal flow and venture capital, a new compa every day—that's over, and that's a good th

What should startups be thinking about, then?

There will be innovation. But it will be i molecular biology, wireless, smaller, faster, cheaper chipsets for wireless.

Do you think the Valley can continue as the c ter of tech innovation?

Can it move from software to molecular ology? Yes. But it's a very different metab lism than when enterprise software was ho There will be some innovative little compa like NetLedger [Ellison owns a controlling terest in NetLedger] showing up—hot little companies offering software as a service fo small business. But by and large, the really novative companies will not be software co

panies. [Innovation] will move to a whole new field of molecular biology and life sciences.

Some economists say tech can't grow at its historic levels, around 10% a year. Do you agree?

I actually think the high-tech industry shouldn't grow. I think companies spend much too much money already on computer systems. I think my industry is deflationary, and prices will come down. Let me be precise. The winning companies will grow quite nicely. But the industry in total will shrink. People will spend less and less money on IT as it becomes more efficient and less expensive. So at the height of the madness in the year 2000, 50% of capital expenditures were on tech. That's insane.

> "Big companies do at least as good a job of innovating as little companies"

Is a tech rebound in sight?

I don't think that there's going to be a turnaround. This is it. This is a new baseline. I don't see a lot of companies turning in great quarters. I think people are holding their expenses and turning in decent quarters. People are comparing the terrible year we had last year to this year. But there is no turnaround.

To what extent are your views colored by your own maturing markets—databases and enterprise apps?

That's an interesting question. Our profit margins in the last quarter were 45%.

The profit margins were great, but I'm talking about top-line growth.

We did have a little bit of top-line growth. Not much. But don't fall into that Silicon Valley trap—who needs profits? The only thing that matters is profits. I don't know why it took so long for people to figure out Oracle generates $4 billion in cash a year. We're wildly profitable. The only business that's better is Microsoft, and they have a monopoly.

You're increasing your presence in India. What sort of jobs are headed to India?

It's not just software engineering. I think accounting jobs are headed to India. I think accounts payable clerks, accounts receivable clerks, and CPAs will be in India. It's not just IT. Once you have a global computer system, you can locate your labor anyplace. We went from these national IT systems to a global IT system, and it gives us tremendous flexibility on how we support our customers.

If you were starting all over again today, would you start your company in Silicon Valley?

Silicon Valley is a great place to start today. There's tons of engineers that are unemployed. There's tons of office space for a buck a foot. I can't think of a better place to start than Silicon Valley today. ■

ROGER McNAMEE: THE VALLEY STILL HAS AN EDG

Roger B. McNamee has been a fixture in Silicon Valley's investment community for more than two decades. But McNamee isn't just any investor. He's also an entrepreneur. As co-founder of Integral Capital Partners in 1991, he pioneered a now common strategy that combines public-market investing with venture capital. He led another trend in 1999, when he co-founded Silver Lake Partners, a tech buyout fund. McNamee shared his views with Silicon Valley Senior Correspondent Linda Himelstein and Correspondent Jim Kerstetter.

Oracle CEO Larry Ellison says that Silicon Valley, as we know it, is dead. Do you agree?

I would not answer the question the same way Larry does for a whole bunch of reasons. First of all, Silicon Valley is the world's most efficient producer of innovation. And it has a set of resources and access to capital that are second to none on a global basis. In the downturn, it's gotten pounded. But I think it will emerge with at least as big an edge coming out as it did going in.

Why is the turnaround taking so long?

The biggest issue the Valley faces is that the excesses of the late '90s were so extreme that the process of working off excess capacity is taking longer than at any time in the past. And it's certainly not done yet.

Then do you agree with Ellison that the industry is going to shrink?

For a while, people will spend less than they did at the peak. But there's nothing wrong with that because what happened before was ridiculous. I don't see a future in which every tech company prospers. I see a world of intense competition in which the average company does relatively poorly. But innovative, successful companies will not only change the world, they will become very big, very profitable, and reward their investors in a way that you won't find anywhere else in the economy.

> "Silicon Valley is the world's most efficient producer of innovation"

Do you think big companies will be responsible for the bulk of innovation in the future?

I just don't believe that. It is just a fact that smaller, more entrepreneurial environments beget more innovation than larger, t reaucratic ones. But I think this is an envi ment that favors established companies. Y are going to have a period when it appear innovation is coming from them, but it real has more to do with incumbency.

I think innovation will come from the Googles of the world and the SalesForce.co that innovate. The venture environment wi be challenging because there is too much m ey and because every good idea will be gr ed by dozens of me-too imitators. The cha lenge will be to break through that.

What are the really good ideas right now?

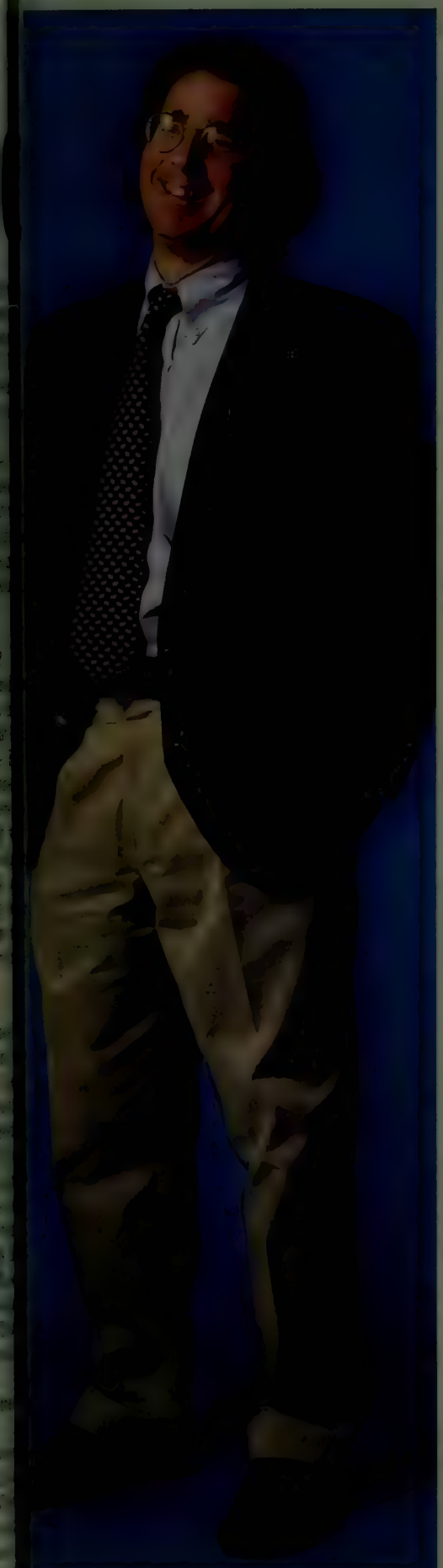
One thing that is important is the proli tion of wireless technology, particularly in world of data. What isn't known is what b ness model is going to work best there. Ea experiments have been wonderful for the c sumer but not very good for the carriers o the vendors of the equipment. But that wi rectify itself. Also, I think there are going be a lot of things around Web services, ad dressing both consumer and enterprise nee I would say Google and SalesForce.com li cast a bright, shining light on Web service

Do you believe tech's future is bright?

I would say the [soft economy creates] very good investment environment. And w shouldn't lose touch with the fact that tec now 8% to 9% of gross domestic product. virtually half of all private-sector domestic ital spending. The continued deflation of th prices of major computing systems is unbe ably powerful in our economy because we a net buyer of that stuff. You look at thing like DVDs or Apple's iPod. Even things like Roomba intelligent vacuum cleaner. These things literally go from brand-new product mass markets in two or three years. That would never have been possible a decade a

But does that deflation of prices mean the si the overall tech industry shrinks?

If the applications of technology were a ic, it would. You've seen that occur in som categories, most notably with PCs. Where differ from [Ellison] is having more confid about the industry's ability to innovate. B to be clear, I think for the next two or th



years, industry revenues could be flat to down. There are big pieces of this thing that represent inefficiency—excess capacity that still needs to be eliminated. But that's a one-time event.

So what are you excited about?

Market leaders have an opportunity to gain enormous advantage in the current turmoil. Against this backdrop, I expect the venture industry to make a lot of investments over the next five years, and some of them are going to work out spectacularly. VCs are in the mode now of sowing a lot of seeds. And I don't know how many flowers are going to grow, but I know there are going to be some flowers.

> "Every good idea will be greeted by dozens of me-too imitators"

Who will be the winners in the years ahead?

The power of market leadership is just enormous. Oracle is brilliantly positioned. Microsoft is brilliantly positioned. Cisco and Dell. But it's not a "small company vs. big company" thing. It's really about having customers who value the products you have sold them. The '90s were about investing in themes. The Internet was hot. PCs were not. The No. 3 guy in a hot industry was more interesting than the No. 1 guy in another industry. Big companies with lots of customers have advantages.

But those advantages disappear very rapidly if you're a follower and not a leader. Think about companies that compete with Cisco. Look at Lucent and Nortel, which are being forced to make radical changes. Juniper is wildly better positioned than Lucent and Nortel, and they are much bigger companies.

What could trip up a tech recovery?

One is the government, broadly defined. Right now, you could be confused about what the government's objectives are. Massive tax cuts at the same time as huge increases in Medicare drug benefits. That places an enormous burden on the economy. We have a good thing here, and we can either nurture it so it lays more golden eggs, or we can have a nice goose dinner. Washington looks to be plucking feathers out of the goose.

The second threat is the mismatch of capital and opportunity. One of the residual issues of the mania is that there's an exceptional amount of capital to invest in startups. I'm nervous that this will result in mindless competition. We're still seeing a lot of that.

Bottom line: I think the burden of proof is on the guys who are negative. We've seen this more than I can count—people thinking there will be dramatic increases in tech spending on top of no interesting innovation. I don't believe it. That feels like the eight ball off the two ball off the four ball into the corner pocket. ■

CEO Meg Whitman:
"We have a
millions of

THE eBAY ECONOMY

e company is not just a wildly successful startup. has invented a whole new business world

By Robert D. Hof

Maybe the folks at eBay Inc.'s annual analyst conference in late 2001 were simply too dazzled by the Web marketplace's blockbuster financial results. Or maybe they had heard one too many dot-com platitudes to heed yet another one. Whatever the reason, when Chief Executive Margaret C. Whitman had the audacity to describe eBay as a "dynamic self-regulating economy," no one in the room even blinked. This overgrown flea market—an economy?

From its humble origins as a trading post for Beanie Babies, is indeed morphing into something entirely new—and a lot bigger than most e realize. This year, at least 30 million people will buy and sell well over $20 n in merchandise—more than the gross domestic product of all but 70 of the s countries. More than 150,000 entrepre- will earn a full-time living selling every- from diet pills and Kate Spade handbags to 0 BMWs and hulking industrial lathes. More obiles, of all things, sell on eBay than even U.S. dealer AutoNation. So what does this o to? "This is a whole new way of doing ss," says Whitman. "We're creating some- hat didn't exist before."

inside one company, anyway. More than a ation, eBay is a nexus of economic activi- ew and vibrant hub for global commerce. ch as anything, this commercial force is hat Whitman said: It's the eBay economy. into the history of the world's great trad- nters, and the parallels to eBay's global tplace jump out. Consider Manhattan, suggests Morgan Stanley & Co. analyst and amateur historian Mary Meeker: The Dutch East India Co. began with a trading community of ragtag merchants. Shut out of the prime markets of the day—slaves and spices—they dealt in less lucrative goods, such as beaver pelts. Over time, the traders flourished, and a larger community began to settle around them. As the community prospered, it needed order. The Dutch turned to a hard-nosed, peg-legged leader named Peter Stuyvesant, who, as governor of New Amsterdam, arranged the construction of streets and other services, such as a police force. Later, Alexander Hamilton greased the burgeoning economy's wheels of commerce by setting up the Bank of New York.

Now look at eBay. It began as trading site for

HOW THE EBAY ECONOMY WORKS

PROMOTE GLOBAL FREE TRADE EBay is on an international expansion binge, buying sites in Germany, Britain, Korea, and China since 2000. Its overseas sales now contribute 30% of transaction revenues.

A Latin venture

CREATE A BANKING SYSTEM Last year, eBay bought payment processor PayPal for $1.5 billion to speed up the velocity of trade. PayPal is now offered on 84% of eBay listings, up from 69% two quarters ago.

ESTABLISH SCHOOLS EBay holds constant classes dubbed eBay University, in c around the country to teach people how to use the site. Participants generally double their selling activity on eBay after taking a class.

An eager st

SET UP A FREE MARKET Founder Pierre Omidyar let people decide what they wanted to sell, encouraging organic growth that continues today as eBay approaches $20 billion in gross sales.

Omidyar at eBay Live!

LEGISLATE LIGHTLY Promoting self-governance, e early on devised a "feedback forum" to let users rate one a to discourage fraud. Now, eBay is taking on a more overt governmental role, writing software to catch crooks early and limiting sales of merchandise such as guns and Nazi memorabilia.

HEED THE VOTERS It wasn't planned, but as users plunged into consumer electronics, cars, and industrial gear, eBay followed. Today, eBay has 27,000 categories, including eight with gross sales of more than $1 billion each.

A Mustang for sale on the site

nerds, the newly jobless, and bored homebound parents to sell subprime goods: collectibles and attic trash. But it quickly grew into a teeming metropolis of 30 million, with its own laws and norms, such as a feedback system in which buyers and sellers rate each other on each transaction. When that wasn't quite enough, eBay formed its own police force to patrol the listings for fraud and kick out offenders. There's an educational system that offers classes around the country on how to sell on eBay. The company even has something akin to a bank: Its PayPal payment-processing unit allows buyers to make electronic payments to eBay sellers who can't afford a merchant credit-card account. "EBay is creating a second, virtual economy," says W. Brian Arthur, an economist at think tank Santa Fe Institute. "It's opening up a whole new medium of exchange."

It's also introducing a whole new mode of management in this Internet If Stuyvesant had a tough bringing the scruffy denizen his freewheeling city to hec the backwater frontier of New World, Whitman and team face even more challer leading their economy in the glare of the wide-open Inter Through the Web, eBay's citizens l access, 24 hours a day, to every tr every sale, every new regulation in the e world. The system is utterly transparent.

Now, thanks to the Web, this transpar is spreading, at varying speeds, throughout entire economy. Executives everywhere are ing a flood of information jumble long-stan relationships with partners, customers, anc vestors. Think of auto dealers, whose custor can learn with a few mouse clicks precisely much the dealer paid for a car. Or electro companies whose products can be subjecte scathing reviews on the very sites where the sold. As information spreads, power move outsiders and makes life miserable for mana who fail to adapt. But this new people powe fers rich rewards for companies that figure how to channel it. The key is to embrace

ransparency and use it to turn customers endors into collaborators and colleagues. Internet creates an economic imperative for arency," says consultant David Ticoll, co- r with Don Tapscott of the upcoming book, *Naked Corporation: How the Age of Trans- cy Will Revolutionize Business.*

t's why eBay's success holds potent man- nt lessons for many businesses. In place of esant's tyrannical approach, seemingly a for conventional business management, Whitman must take a more laissez-faire ach. It is based on cooperation and finesse, ercion and force.

ake sure eBay 't do something ncurs the wrath citizens and in- revolt, eBay's executives work more like ervants than corporate managers. They e populace through online town hall meet- nd provide services to keep them happy—usiness humming.

challenging as it is, the collaborative ap- offers awesome benefits. Unlike most onal companies, eBay presides over an ex- g ecosystem—one whose limits are still wn. Its magic is that as buyers and sellers o the site, they not only feed on it, but h it. By rating each other on transactions, stance, both buyers and sellers build up tions they then strive to maintain, set- standard of behavior that reinforces eBay's . It's a powerful dynamic that only a hand- other companies can claim. One example is soft Corp. It builds a software universe rows bigger and richer as thousands of nies and programmers add their own ap- ons. This in turn attracts more users, fu- n ever-expanding ecosystem. The upshot, Harvard Business School professor David B. "You get the incredible leverage of other doing all your work for you."

ay's powerful vortex is pulling ever larger s into its economy. The company's sellers retching far beyond eBay's specialty of nd remaindered goods—they're pushing e heart of traditional retailing, a $2 trillion t. Among eBay's 12 million daily listings w Crest toothbrushes and the latest DVD s, and giants such as Sears Roebuck & d Walt Disney Co. are selling brand-new there as well. More than a quarter of of- are listed at fixed prices familiar to mass- t consumers. The result, says Bernard H. baum, president of the Princeton (N.J.) buyout firm Children's Leisure Products "They're coming right for the mainstream retail business."

ay's deft management is apparent in its als. Last year, profits rocketed 176%, to illion. Net sales, from transaction fees on lion in gross revenues, hit $1.2 billion. In cond quarter, revenues shot up 91% from a go, to $509 million. It now looks as if Whitman's forecast two years ago that eBay would grow to $3 billion in net revenues by 2005—derided at the time as a stretch—will be met easily, barring an unexpected slowdown. That kind of growth has pushed eBay's stock into the stratosphere, with shares rising 47% from the start of the year, to $102.

As the eBay economy expands, managing it could get a lot tougher. The move into the mainstream, in particular, poses thorny challenges. It not only means balancing the needs of big corporate vendors with those of small fry—no easy task—but also remodeling eBay to attract millions of newcomers. For the many who haven't yet tried eBay, the process of listing items on the site, packing them up, and mailing them can be cumbersome and confusing. And, for many, the brand still emits the stale odor of thrift stores—or worse. Reports of fraud on auction sites—mostly on eBay, which still accounts for 80% of the market—are rising sharply even as eBay keeps hiring more virtual cops.

B-school terms like "drive, force, commit don't apply. We're...listening, adapting, enabling," says an exec

The question is whether the company's traditional laissez-faire governance can sustain its growing economy. It now appears that making shopping on eBay as safe and easy as a trip to Wal-Mart may well require a more forceful approach—simplifying payments, reducing the hassles of shipping goods, and cracking down on the rising number of crooks who are prowling the site. But pushing through reforms is tough because eBay's millions of passionate and clamorous users demand a voice in all major decisions. Concedes eBay director Robert C. Kagle, a general partner at venture firm Benchmark Capital: "These users can organize themselves if we do something they really don't like."

EBay managers are reminded of this day after day. Whitman says it often takes six months for new managers to adjust to the democratic regime. "Some of the terms you learn in business school—drive, force, commit—don't apply," says former PepsiCo Inc. exec William C. Cobb, now senior vice-president in charge of eBay's international operations. "We're over here listening, adapting, enabling."

This process is clear in one of eBay's most cherished institutions: the Voice of the Customer program. Every couple of months, eBay brings in as many as a dozen sellers and buyers to ask them questions about how they work and what else eBay needs to do. And at least twice a week, it holds hour-long teleconferences to poll users on almost every new feature or policy, no matter how small.

The result is that users feel like owners, and they take the initiative to expand the eBay Economy—often beyond the execs' wildest dreams. Stung by an aerospace downturn, for instance, machine-tool shop Reliable Tools Inc. tried listing

a few items on eBay in late 1998. Some were huge, hulking chunks of metal, such as a $7,000, 2,300-pound milling machine. Yet they sold like ice cream in August. Since then, says Reliable's auction manager, Richard Smith, the company's eBay business has "turned into a monster." Now, the Irwindale (Calif.) shop's $1 million in monthly eBay sales constitutes 75% of its overall business. Pioneers such as Reliable prompted eBay to set up an industrial products marketplace in January that's on track to top $500 million in gross sales this year.

When laissez-faire isn't enough: A hands-on approach to cars has paid off. Now they're eBay's biggest market

Yet as far as eBay's entrepreneurs have taken its economy, they can't do everything. Just as people and businesses in a national or regional economy often need the rules and assistance only a government can provide, eBay often has to step in. So the company is increasingly supplementing the invisible hand of its economy.

Nowhere has this approach been more apparent than in eBay Motors. When eBay manager Simon Rothman first recognized a fledgling market for cars on eBay in early 1999, he quickly realized that such high-ticket, high-touch items would require a different strategy than simply opening a new category. To jump-start its supply of cars and customers, eBay immediately bought a collector-car auction company, Kruse International, for $150 million in stock, and later did a deal to include listings from online classifieds site AutoTrader.com LLC. Rothman also arranged insurance and warranty plans, an escrow service, and shipping and inspection services.

This public-works project did wonders. Sales of cars and car parts, at a $5 billion-plus annual clip, are eBay's single largest market. That has catapulted eBay in front of No.1 U.S. auto dealer AutoNation in number of used cars sold. About half of the sellers are brick-and-mortar dealers who now have a much larger audience than their local area. "EBay is by far or my better sources for buyers," says Bra Bonifacius, Internet sales director at I Stallings Ford in Oak Ridge, Tenn.

EBay is also beefing up its services—mo all, its police force. While the company cl that fraud happens in less than 0.01% transactions, its own surveys reveal that of fraud is a n turnoff for prospe customers. So last year, eBay fo a Trust & Safety I now staffed by several hundred eBay emplo worldwide. They do everything from trollin site for suspicious listings to working with enforcement agencies to catch crooks. EBay has developed software that recognizes pat of behavior common to previous fraud c such as sellers from Romania who recently ed selling large numbers of big-ticket it Says Trust & Safety Vice-President R Chesnut: "As time goes on, we're exerc more control."

How much? Figuring that out is eBay's riding challenge in years to come. As it tries commodate mainstream merchants, for inst eBay is facing the same challenge city co face when Wal-Mart comes to town. "EBay's ing a fine line trying to satisfy both merchan powers and mom-and-pops," says Pacific G Equities Inc. analyst Derek L. Brown.

For now, the big brands, which still ac for under 5% of eBay's gross sales, seem bringing in more customers than they steal torola Inc., for example, helped kick off a wholesale business for eBay last year, s excess and returned cell phones in large "We bring a community of buyers to eBay," Chip Yager, a director of channel developm Motorola PCS. Thanks to the initiative of e lished companies such as Motorola, eBay's v sale business jumped ninefold, to $23 milli the first quarter.

As businesses on eBay grow larger, they the creation of even more businesses. A army of merchants, for instance, is mak business out of selling for other people. Fr most none a couple of years ago, these so- Trading Assistants now number nearly 2 One of them, a startup called AuctionDrop plans to open a nationwide chain of store where people can drag in stuff for Auctio to sell on eBay—no clicks, no hassles.

That organic growth makes it exceed tough to predict how far the eBay econom go. Ask an analyst, a seller, a partner, and all have different forecasts for eBay's f the world's biggest mall, the Windows of e merce, even the next Wal-Mart. Whitma fesses not to know. "We don't actually c this," she admits. "We are not building this pany by ourselves. We have a unique part millions of people." For the foreseeable f eBay's fate will be up to them.

THE JOB AHEAD FOR EBAY

WOO THE GIANTS WITHOUT ANGERING THE LITTLE GUYS EBay wants to be the online outlet for the likes of Dell and Sears. But staying true to its original small-fry users demands managerial finesse.

RESPOND FASTER TO FRAUD Although fraud hasn't yet spiraled out of control, it's a growing concern. EBay must get more users involved in spotting fraud, which would help cap the crime and bolster users' confidence.

MAKE SELLING EASIER It's still a hassle to list items, communicate with buyers, and ship packages. EBay must offer easier listing software, arrange with shippers for more convenient pickups, and establish drop-off points.

MARKET TO THE MASSES EBay has a powerful brand, but many people still don't realize the variety of merchandise—from collectibles to cars—on the site. An educational campaign could bring in millions of new users.

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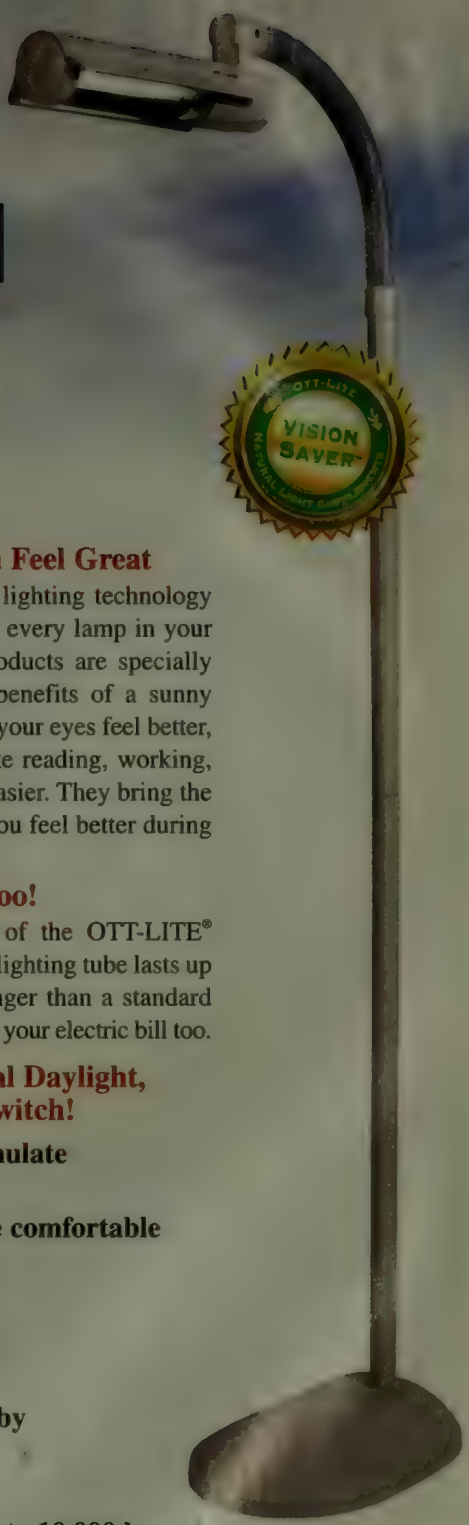

The Science of Seeing

we age, our eyes begin to fail us. For generations, our were meant to focus on large objects, at a distance. nodern world has changed that, and now we need to mall objects at very close range. Natural sunlight is est light for everything we do. The glare from ordinary bulbs can cause eye strain, and headaches. descent bulbs simply don't provide natural light.

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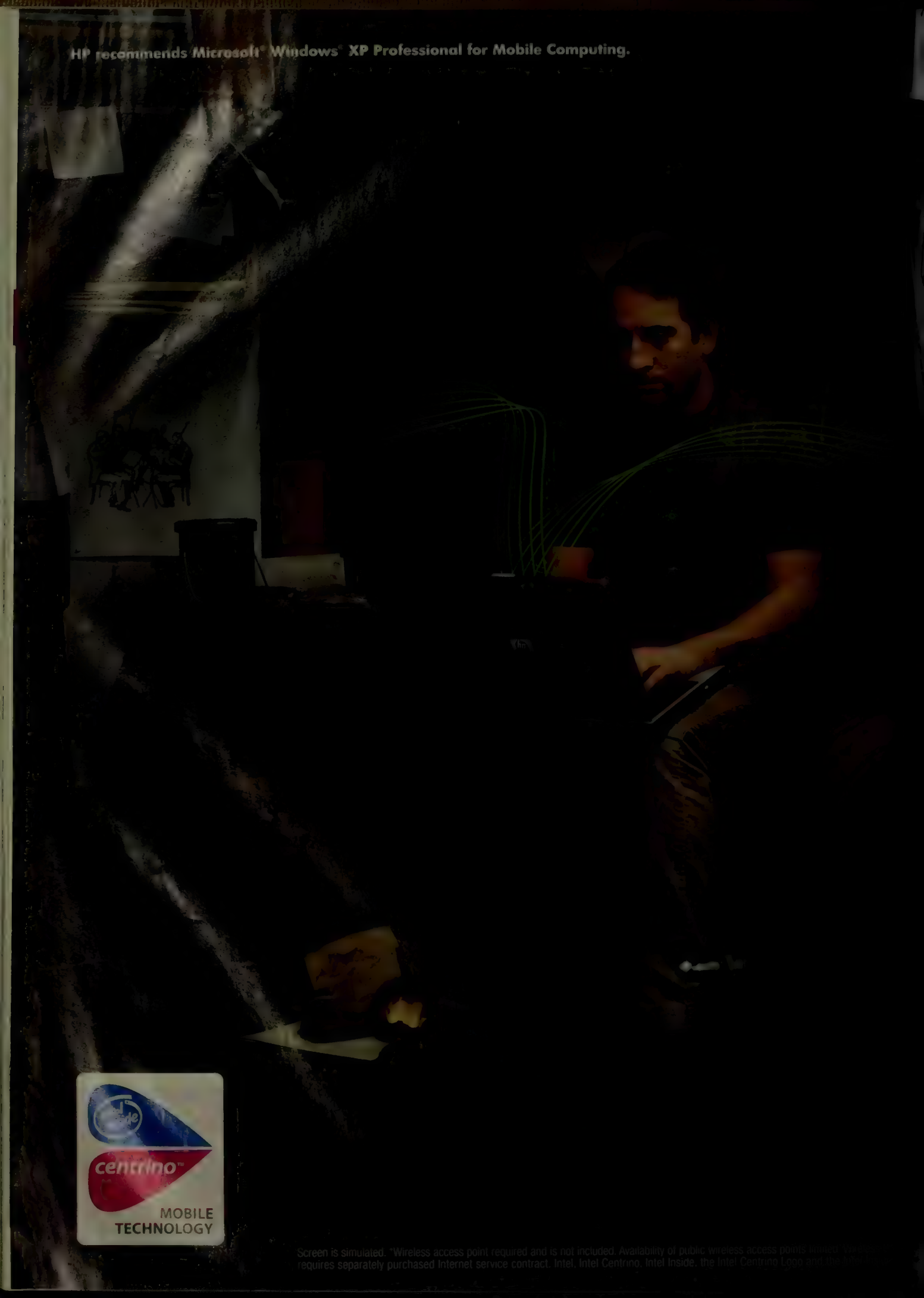
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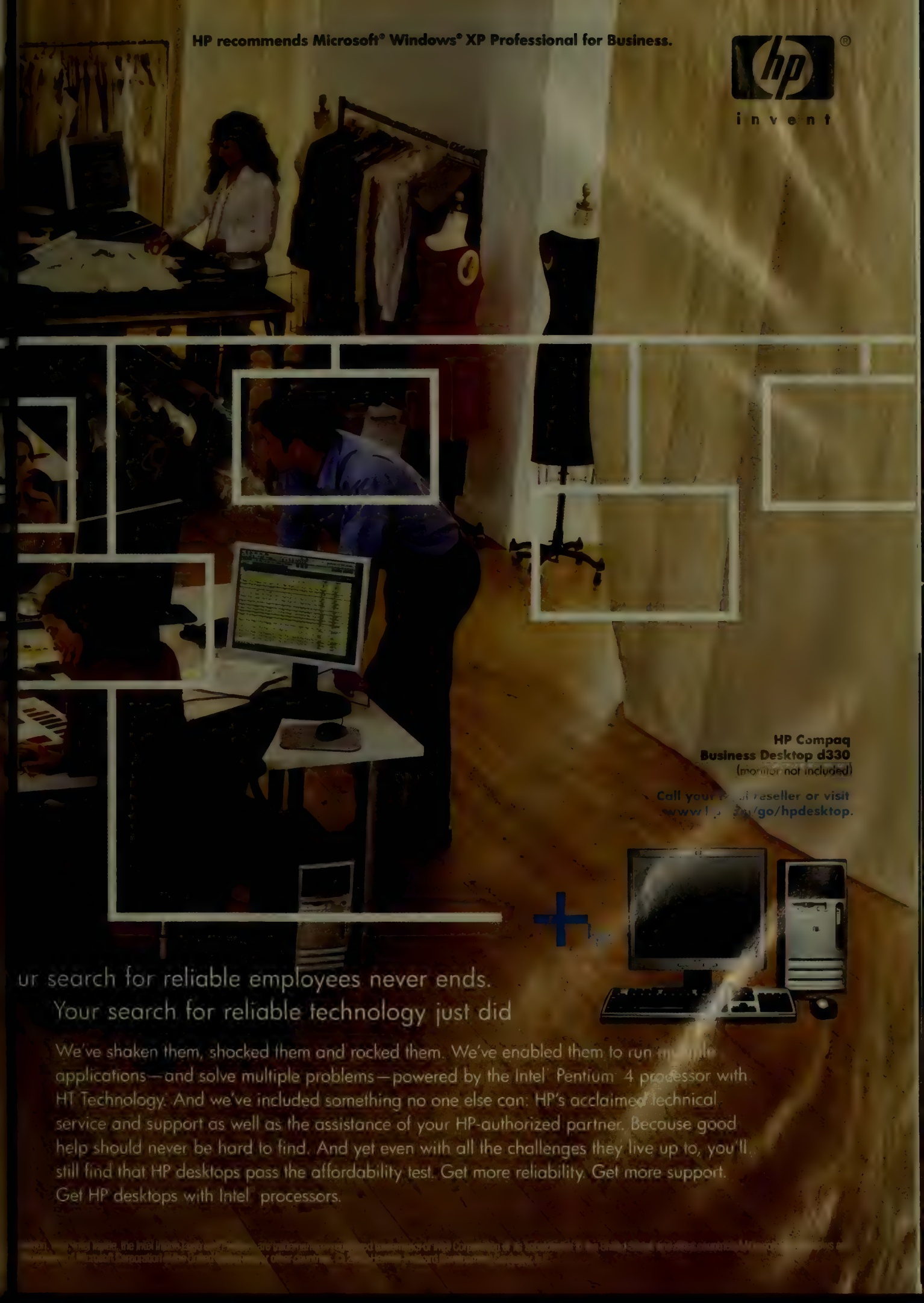
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YIN AND YANG STOCKS

Many tech issues are still best suited for trading. But these days, there are some you might buy and hold

By David Henry

Tech stocks are back. So, too, is the problem that frustrated so many vestors during the late 1990s boom: how to size them up. The first dle is the cost because, once again, tech stocks are hugely expensiv the usual measures. Those in the Standard & Poor's 500-stock in are priced at 33 times their estimated 2003 earnings, a 79% prem to the index as a whole. Shares of Internet leaders Amazon.com Yahoo! Inc. are off the radar at 70 and 87 times expected earni respectively.

What's a tech investor to do? Start by dividing stocks into two catego those for trading and those for investing. With trading stocks, you make money figuring out whether other traders will keep buying or start selling the stock and positioning yourself accordingly for a few weeks or even days. By contrast, with investing stocks you aim to buy into a company at an attractive price, given the worth of its assets and likely future profits, regardless of when the value will be recognized by the market. This way, you can steer clear of overpaying for fashionable dogs.

There's nothing revolutionary about this strategy, of course. It's just a question of calmly mixing and matching some old, and apparently somewhat contradictory, stock market wisdom and applying it to a hot market. About 70 years ago, British economist John Maynard Keynes, who earned stock market fortunes for his Cambridge college and a London-based insurance company, said investors should view the market as a beauty contest, and they should mainly buy trading stocks that other people would find attra American hero Benjamin Graham, the fath modern securities analysis, bristled at that He lamented that stock buyers, though almo ways called investors, are often actually spe tors. Instead, he preached that they should a hard-nosed assessment of the inherent va companies and search out investing stocks.

At the height of the NASDAQ market boo early 2000, the very idea that any tech could still be an investing, or value, stock implausible. Aside from the much-hyped Int stocks, shares of such solid companies as crosoft Corp. and Intel Corp. soared as if gr in the companies were boundless. But mu the speculative fever that drove the big n way up cooled way off, and the stocks deflat their businesses suffered an inevitable cy downturn. Now, these companies are set

Traders control at least one-third of the money invested in tech stocks

into a comfortable maturity with dominant franchises and relatively predictable earnings that can be sized up for investment.

Forget eyeballs, first-mover advantage, and the other fanciful metrics that the dot-coms used to toss around. Investing stocks tend to have lower price-earnings ratios than high-flying Internet stocks, balance-sheet strength, and the resources to pay dividends, if they wish. What's more, they seem able to keep earning money throughout the economic cycle, and they spin off cash, lots of it. Their baseline business through the cycle yields data that can be analyzed to reach reasonable estimates of what they are worth.

For investors scorched by cash-burn in the bubble days, when telecom and Internet companies and some other techs frittered their funds with all the abandon of a sophomore on spring break, the positive cash flow that the investing stocks throw off is especially appealing. Microsoft alone has piled up $49 billion of the stuff, equivalent to about $4.50 per share. "Cash doesn't lie," says Kevin Landis, portfolio manager at San Jose (Calif.)-based Firsthand Funds.

Truth to tell, there are some dependable companies whose relatively low p-e ratios make them good candidates for investing stocks. For example, Affiliated Computer Services Inc. offers investors a chance to participate in nearly 20% earnings growth from demand by corporations and governments for outsourced IT. ACS shares are priced at a modest 19 times earnings, and most of the company's revenue is dependable because it's largely based on contracts that are renewed regularly. IBM, the granddaddy of them all, has a p-e of around 19 and pays a dividend. It currently yields 0.8%, but that has been growing at a smart 7.5% annual clip. Now, Microsoft, with a p-e of 25, is starting to pay dividends. PC maker Dell Inc. has many of the characteristics of an investing stock: a strong franchise and savvy marketing that produce 15% annual earnings growth and 40% returns on capital. Although it pays no dividend, it isn't lumbered with any debt. But lately Dell's p-e has ratcheted up to around 33, diminishing some of the stock's investing appeal. Even Intel, with a PC-processor franchise so strong that it spits profits even during the tech bust, is starting to look like a trading stock.

In fact, after the dizzy 24% runup in the S&P 500 Info Tech index since Mar. 31, more and more shares are moving into the trading category. Their price action alone is the big draw for one group—the momentum traders. They don't care a fig about the fundamentals of a company's business. They may not even know what it does. Their philosophy is simple: What goes up is going to go up some more.

They have a point. Mutual- and pension-fund managers are judged according to a benchmark index and, if one stock or a group of stocks in it is shooting up, they can't afford to be left behind. They all pile in, creating a bandwagon effect. Consider Applied Materials Inc., which has one of the largest market caps in the S&P 500 Index. The stock has run up 57% since March to $19.77, even as analysts have trimmed their earnings estimates from 49¢ a share to 47¢ for the fiscal year through October, 2004, according to Thomson First Call.

Why do momentum traders have such power? Simple. They control at least one-third of the money invested in tech stocks, says Walter Price Jr., veteran manager of the Pimco Global Technology Fund. And if they can generate sharp and fast runups in prices, their influence can be equally vertiginous if they fall out of love with a shooting-star stock. During the past 12 months, one-third of tech stocks suffered single-day drops of at least 20%, according to Bear Research. One of them, Nokia Corp., plunged 20% on July 17 after execs said the fall in the U.S. dollar would halt revenue growth from cell-phone sales in this year's third quarter.

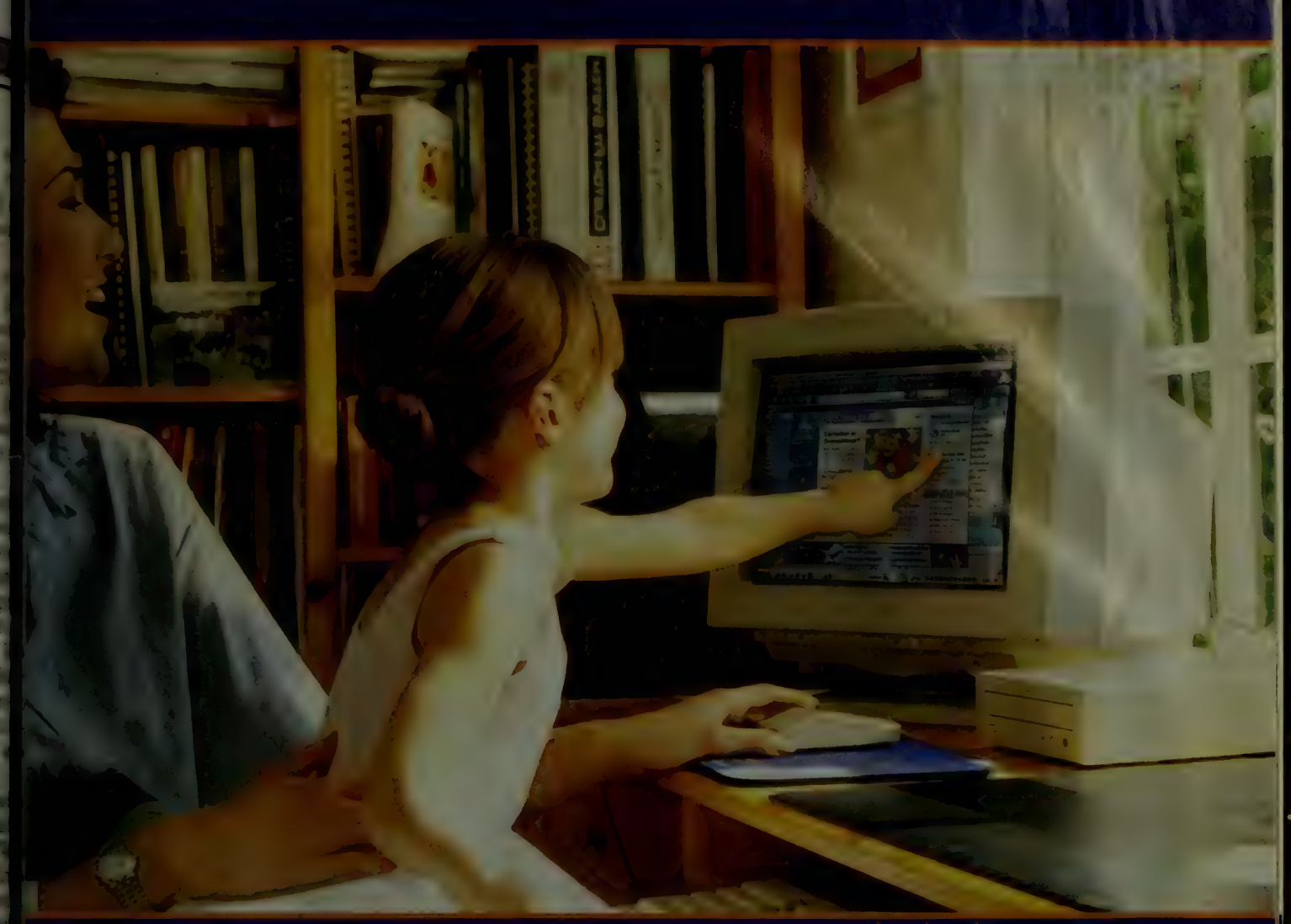
Another big group of traders looks for a different kind of another kind—in earnings. They focus on companies they think are likely to beat the market's expectations. A positive earnings surprise can produce a real pop. For example, eBay

TWO APPROACHES TO THE MARKET

Depending on how long their time horizon is, investors in tech equities need to weigh completely different criteria

Data: *BusinessWeek*

TRADERS		INVESTORS	
Focus on factors that affect short-term buying decisions by others		Emphasize the measures that show the potential for gains over the long haul	
INDICATOR	COMMENT	INDICATOR	COMMENT
EARNINGS EXPECTATIONS	The stocks of companies likely to beat expectations tend to rise	P-E RATIO	The standard measure of value and potential return on investment
ESTIMATE REVISIONS	Rising earnings estimates from analysts will lure more buyers	DIVIDEND YIELD	Shunned in the '90s, this return on investment is cash in the bank
PRICE MOMENTUM	Rising stock prices attract fund managers who don't want to be left behind	NORMAL GROWTH RATE	Through economic ups and downs, reliable growth means higher returns
STORIES	Dazzling products that might change the world make stocks seem priceless	BALANCE-SHEET STRENGTH	Companies with lots of cash and little debt aren't captive to traders' fads



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whose stock has been one of the star performers in the past year, has beaten earnings estimates by 2¢ to 5¢ a share in each of the past four quarters. The same can happen when Wall Street's much-maligned analysts raise their estimates of company earnings. A classic example is SanDisk Corp., a leading supplier of flash memory for digital cameras. The stock shot up 246%, to $58.32, from Mar. 31 through Aug. 4 as estimates for this year's earnings more than doubled from 84¢ a share to $1.87. Estimates are soaring because the flash memory that the company makes is in short supply as demand for digital cameras climbs. The problem for the stock, says Price, is that the profit windfall to the company won't last when competition moves in and demand growth slows. "Everyone who owns that stock knows they will have to sell, whether today or six months from now," he says.

As anyone who went along for the wild late '90s ride in stocks knows, traders can't resist a good story. The merest hint that a company has a dazzling product is often enough to set its stock alight. Shares of wireless-chip supplier Unova Inc., for example, rose 10%, to $11, on June 26 after MSN.com reported on the potential of its RFID, or radio frequency identification, tags, which track retail products. Since these smart tags [illegible] their infancy and the company is losing [illegible] the story and the hope that it might one [illegible] come a big money-spinner powered it high[illegible]

Still, the frontier between trading stocks [illegible] vesting stocks isn't fenced off. Stocks ca[illegible] and re-cross the border with regularity [illegible] shares are up more than 54% since March, [illegible] initially by attractive fundamentals. But [illegible] the momentum crowd has jumped aboard [illegible] ride. Meantime, other traders are attrac[illegible] the prospects of upward revisions of earni[illegible] timates as the economy improves. In fact, e[illegible] revisions and stock-price momentum are [illegible] cally highly effective predictors of stock re[illegible] year later, according to Vadim Zlotnikov, c[illegible] vestment strategist at Sanford C. Bernstein

Sometimes, when companies have high [illegible] tial earnings growth, it can be difficult [illegible] whether the stocks are moving on tradi[illegible] mentum or on real market insight into th[illegible] tential future value. Consider eBay. Co[illegible] Wall Street forecasts figure its earnings wil[illegible] from $1 a share in 2002 to $1.50 in 20[illegible] $2.09 next year, according to Thomson. Bu[illegible] if those estimates prove right, buyers [illegible] stock are still taking a speculative plunge [illegible] the shares at $103 re[illegible] they were trading at 49[illegible] the 2004 estimates, a 49[illegible] mium to the current [illegible] stocks in the S&P IT ind[illegible]

Clearly, investors som[illegible] need to think like trade[illegible] Coburn, global tech [illegible] strategist at UBS Re[illegible] says they should co[illegible] what he calls tactical s[illegible] tion. This means buying [illegible] of solid companies, such [illegible] tel or Cisco Systems[illegible] whose sales are fairly [illegible] advance as the econom[illegible] covers, giving them [illegible] chance of pleasing t[illegible] with earnings surprises [illegible] future. The tricky part [illegible] ting out before the [illegible] traders start to dum[illegible] stock because they th[illegible] may soon run out of ste[illegible]

Nobody said it would[illegible] be easy to make mon[illegible] tech stocks. But life ca[illegible] lot less nerve-racking aft[illegible] work out how much [illegible] you're willing to assume[illegible] whether that makes you [illegible] vestor or a trader. Once [illegible] decided who you are, it[illegible] to stick to your role. A[illegible] personality will only m[illegible] that much harder to [illegible] guish the risks from t[illegible] portunities in the marke[illegible]

THE LONG AND SHORT OF STOCKS

COMPANY/ SYMBOL	STOCK CHANGE* SINCE MAR. 31	COMMENT
INVESTOR STOCKS		
AFFILIATED COMPUTER ACS	4%	Trades near market p-e at 19 times 2003 earnings. Has substantial and growing repeat revenues.
DELL DELL	22	Strong franchise produces dependable earnings, 15% earnings growth, 40% returns on capital. No debt. Trades at p-e of 33.
IBM IBM	3	Dividends growing 7.5% annually. Strong franchise yields relatively steady profits.
INTEL INTC	54	Strong franchise produced profits even in tech-spending bust. No debt. Pays dividend.
MICROSOFT MSFT	8	Cash horde of $4.50 per share. Virtual monopoly franchise yields dependable profits. P-e of 25 not much higher than market.
TRADER STOCKS		
BROADCOM BRCM	69	Market loves rising sales of wireless Internet equipment, higher earnings estimates, and expected 30% annual earnings growth.
EBAY EBAY	21	Beat estimates by 2¢ to 5¢ a share past four quarters. Projected annual growth 40%. Trades at 49 times 2004 estimates.
PMC-SIERRA PMCS	119	Talk of renewed demand for its specialty networking chips, expectation of profits after three years of losses.
UNOVA UNA	161	Surging on stories of retailers demanding wireless chips embedded in merchandise for easy checkout. Analysts expect profits next year.
VITESSE SEMI VTSS	223	Rocketing on hope for new demand for optical-communications gear and on new estimates that losses will decline sharply.

*Through Aug. 4

Data: Bloomberg Financial Markets, Thomson First Call, Standard & Poor's

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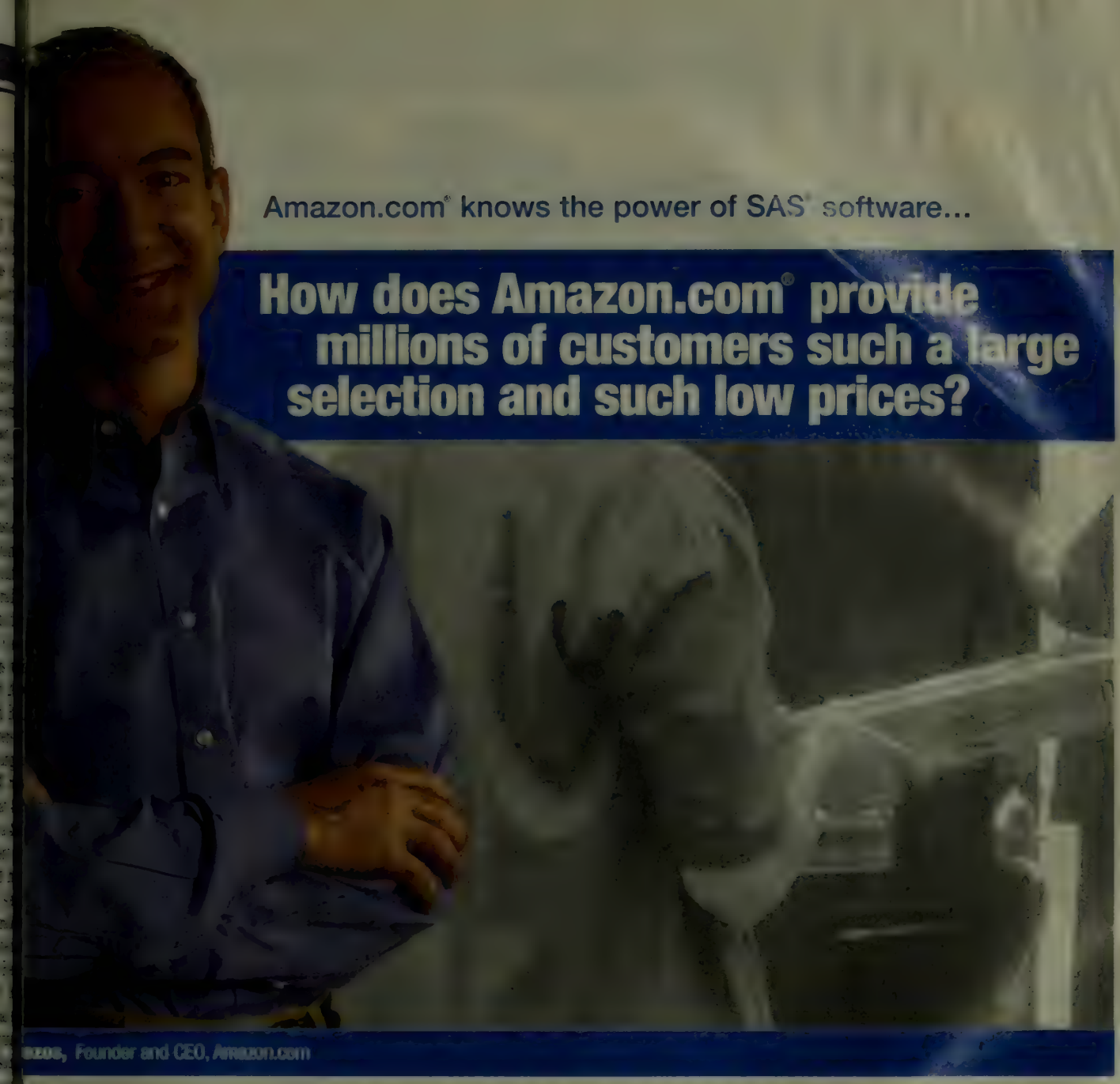

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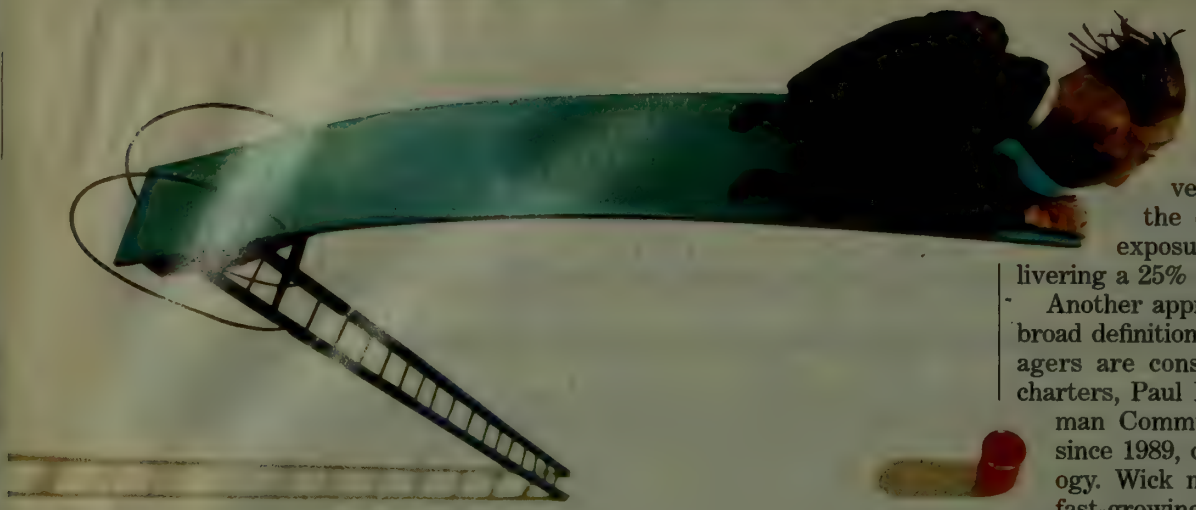

TAKING THE PLUNGE

How to get back into tech? A carefully chosen fund may be the best path

By Dean Foust

Investors are still smarting from the bursting of the tech bubble in 2000, but wariness needn't become a phobia. There are plenty of strategies for placing diversified bets to reduce high anxiety. Start with a good tech-oriented mutual fund with a savvy manager, low fees, and a long-term track record. Brian Portnoy, a mutual-fund analyst at Morningstar Inc., recommends Northern Technology Fund, which boasts a 9.58% average annual return since its inception in 1996.

For investors who may be warming up to tech but are not quite ready to go whole hog, Portnoy suggests buying a "stealth" tech fund—a growth fund run by a manager well-versed in the industry. One of vorites is the Fidelity Appreciation Fund, r Harry Lange, a former sector analyst for Fideli vestments. Lange deftly anti the current rally, raising his exposure to tech from 21% to 41 livering a 25% return so far this year.

Another approach is to consider funds broad definition of technology. While man agers are constrained by narrow inves charters, Paul H. Wick, who has run the man Communications & Information since 1989, can invest in health-care te ogy. Wick now devotes 22% of his fi fast-growing stocks such as medical ment maker Beckman Coulter Inc. and Diagnostics Inc., one of the largest clinical- erators in the U.S. This year his fund about 22%.

If you want to diversify, simply buying tech funds may be a mistake. Arnie Be tech strategist for SoundView Technology notes that 44% of all tech equity is now c trated in just five stocks: Microsoft, Cisc tems, Oracle, Dell, and IBM. To avoid too much of the same stocks, he suggests exchange-traded funds that focus on tech

ETFs are baskets of stocks that trade major exchanges like common stocks. A their advantages over mutual funds: The investors control over when they take gains and losses, they trade continuously, a mix of stocks in the basket is fixed. B recommends the iShares Goldman Sachs working fund, which invests in Cisco and networking companies, or sister funds ded to semiconductors and software.

Sometimes a broad index fund is the plest answer. But avoid the NASDAQ 100- Index, which now has only 55% of its c ization in tech stocks. Instead, says Howa Simons, a finance professor at the Illinois tute of Technology, consider the North fund family's Pacific Stock Exchange Tec Index fund, which has averaged 11.2% r over the past five years.

For investors, the message is clear: Techg can be treated with simple therapies.

BASKETS FULL OF TECH

NAME	SYMBOL	PRICE*	RETURNS		COMMENT
			YTD*	5-YEAR AVERAGE	
■ ISHARES GOLDMAN SACHS NETWORKING	IGN	$20.69	52.9%	NA	With low expenses, Goldman's exchange-traded funds are a cheap way of playing tech r
■ FIDELITY CAPITAL APPRECIATION	FDCAX	20.26	25.2	3.8%	Run by former analyst Harry Lange, who h proven deft at knowing when to bulk up on
■ NORTH TRACK PSE TECH 100	PPTIX	17.40	28.5	11.2	A better way to place a broad tech bet than NASDAQ 100, now larded with nontech s

* As of Aug. 4

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SOMETHING VENTURED, PLENTY GAINED

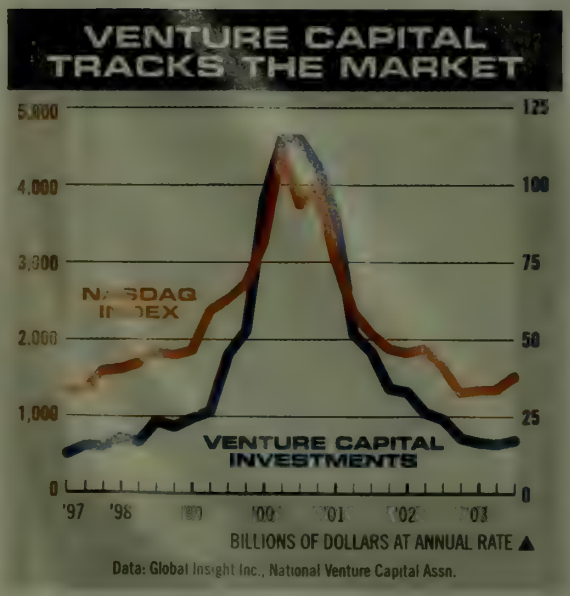
Finally, VCs are ready to jump back in–with enough cash to fuel a rebound

By Michael J. Mandel

As the economy and the tech sector try again for a sustained recovery, remember that the 1990s boom was as much about finance as about technology. The Internet was the star—but it was the ability of new companies to raise hundreds of billions of dollars in venture capital that supercharged growth and innovation.

Indeed, access to capital played a key role in powering the 1990s surge in tech hiring and spending. Much of the money taken in by young companies went to pay for programmers, new computers, and software. The numbers were huge—the $90 billion increase in venture finance alone from 1997 to 2000 helped fund the $120 billion rise in tech spending for all businesses.

A strong venture capital rebound could be more critical for growth in the coming years than it was in the 1990s. For one, VC funding is starting from a higher base. Venture investments hit a $17 billion annual rate in the second quarter of 2003, up a bit from the first quarter. That's way down from the 2000 peak, but far more than the $4 billion invested annually in 1992-94.



With the NASDAQ stock index up some 25% since March, history suggests that venture capital will soon follow. An additional $10 billion in venture capital—not unreasonable, with venture firms sitting on about $70 billion in uncommitted funds—would translate into as many as 85,000 new jobs for programmers, biotech scientists, and the like (assuming salaries and benefits average $120,000 [illegible] and most hiring occurs in the U.S.). Or, if on new equipment or software, that $10 would add 2.5 percentage points to the [illegible] rate of business tech spending.

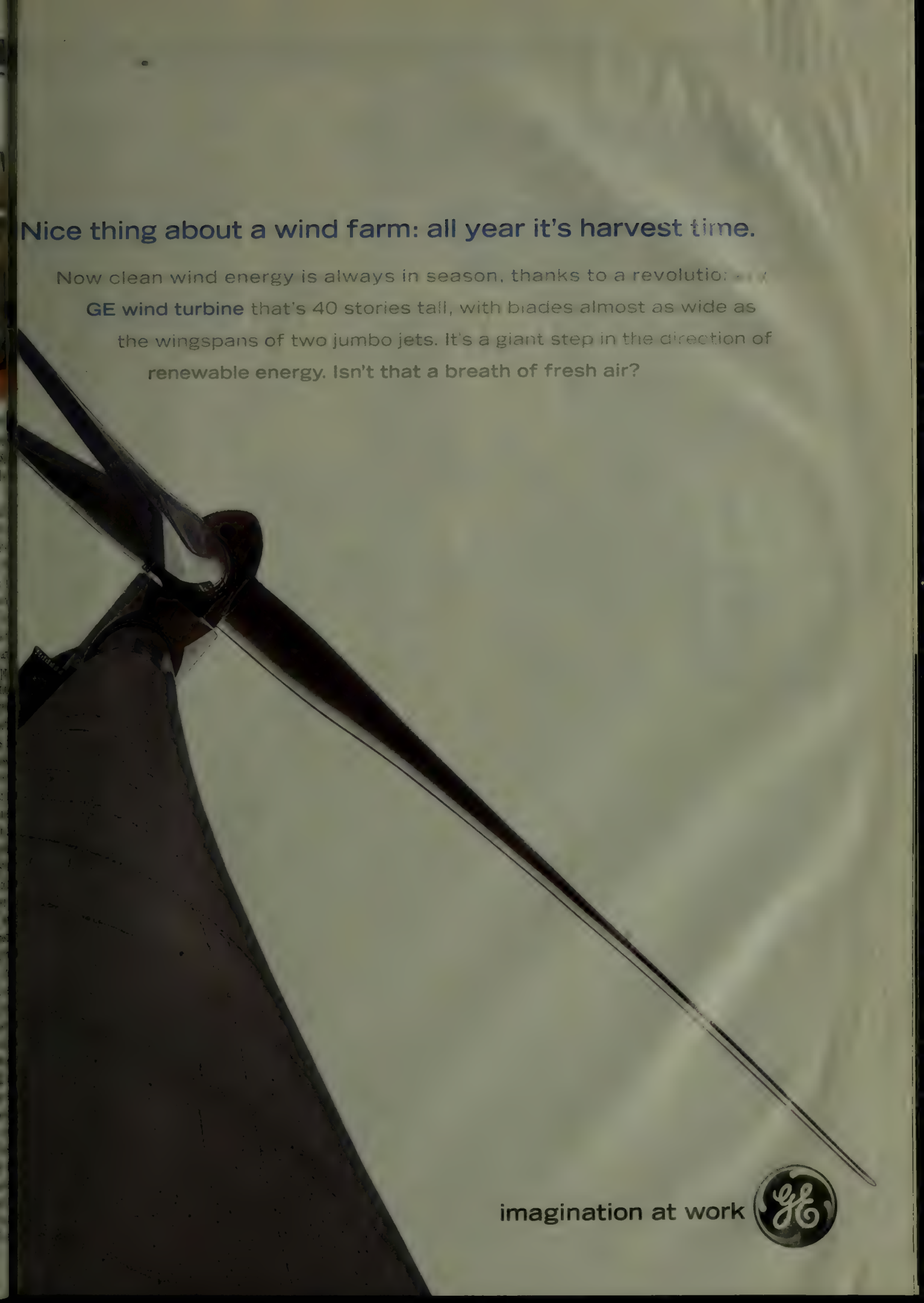
Why should venture capitalists, still [illegible] from recent losses, jump back in? VC [illegible] ments usually follow the movements [illegible] NASDAQ, the home of most tech IPOs, wit[illegible] of a year or less. That pattern held in th[illegible] 1990s, and over the past few years, whe[illegible] ture capital and the market marched in t[illegible] during boom and bust. The reason? Takin[illegible] ups public is easier when stock prices are[illegible]

Now, as tech stocks recover, the proc[illegible] starting again. VCs "have been waiting [illegible] sign that their investments will be wor[illegible] time and risk," says Kirby Wadsworth[illegible] president for marketing and business de[illegible] ment at Revivio Inc., a Lexington (Mass.) [illegible] up that just received $21 million in new v[illegible] funding. Globespan Capital Partners, an in[illegible] in Revivio, expects its overall investmen[illegible] 2003 to be 50% to 100% higher than in 20[illegible]

Revivio, which is developing a produc[illegible] will make it easier to back up and restore [illegible] will spend the vast majority of the mon[illegible] salaries for software engineers and other p[illegible] development jobs. Other companies are [illegible] venture funds to beef up their tech infrastr[illegible] Inphonic Inc., a rapidly growing distribu[illegible] private-label wireless services, based in [illegible] ington, D.C., just raised $56 million in new[illegible] ture financing. Part of the money, says CEO [illegible] Steinberg, will go to automating customer s[illegible] upgrading computers in call centers, and in[illegible] ing financial reporting software. Betwee[illegible] and the end of 2003, capital spending will to[illegible] million, up more than 100% over a year ea[illegible]

Adding to the impact, higher spendi[illegible] tech by venture-financed companies coul[illegible] prove sales and profits at tech companies, [illegible] ing stock prices and making it easier to [illegible] money. That's what happened in the late [illegible]

Only in the U.S. do the stock market, v[illegible] capital, and tech spending reinforce one a[illegible] like this. And this may be a very good re[illegible] believe in a bright future for tech.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the wingspans of two jumbo jets. It's a giant step in the direction of
renewable energy. Isn't that a breath of fresh air?
imagination at work

COMPANIES THAT REALLY GET IT

Using tech to chip away at problems is what gave these leaders a winning edge

By Heather Green

It's a piece of cake to pick tech companies that have figured out ways to use tech gear to stay ahead of rivals. Just think of Dell Computer Corp. and how its pioneering build-to-order system propelled it to No. 1 in PCs. Or eBay Inc., which dominates the online auction market with 1 billion in listings. But companies outside of techdom are also using technology to claim a competitive advantage for themselves and their stockholders.

These companies aren't tech fetishists. They just make technology work to accomplish their business strategies. Instead of big, bet-the-farm investments, they use tech to chip away at business problems, looking for incremental improvements year after year that add up to a major advantage. It's a long-term commitment that typically comes from the top. The CEOs of insurer Progressive, trucker Yellow, and auto-equipment maker Gentex have long stressed tech and have kept IT spending steady even during the downturn. The formula is working. In the past three years, these three stocks are up an average of 110%, vs. a 31% drop in the Standard & Poor's 500-stock index.

Progressive Corp. has spent years using technology to raise the bar in car insurance. In 1997, the company pioneered selling online and using digital cameras and wireless Net links to process accident claims—sometimes writing checks in under 20 minutes. It built a Web site for its 30,000 independent agents that dishes up sophisticated pricing tools, paperless filing, and policy updates to improve productivity and loyalty. Since starting its Net initiatives, Progressive's revenues have jumped from $3.4 billion in 1996 to $9.5 billion in 2002—an average increase of almost 20% annually, vs. 5% for the overall auto-insurance industry. Analysts expect revenues to hit $11.8 billion this year.

Using tech effectively often means being more demanding than the average customer. William D. Zollars, Yellow Corp.'s CEO, set tough standards for tech projects in 1997: They c take longer than a year to implement, a had to have a 15% rate of return. Such principles have helped the 325 employees company's Yellow Technologies lab a most of the trucker's operations—quick profitably. Two years ago, the $2.6 billio pany installed software that lets Yellow staffing on its loading docks daily based dictions of labor demand. The result? Th averages 90 workers per week, down fr before, even as the number of shipme increased.

Even in industries with many tech players, it's possible to stand out. JetBlu ways Corp., which only started operat 2000, was the first airline to allow pilots ry laptops that automatically update fligh uals. And it was the first to have a virt center, with 700 reservation agents w from home in Salt Lake City. Meantime its tickets are booked through JetBlu site, saving on agent commissions and travel sites' fees. Add it all up, and in t ond quarter, ended June 30, JetBlue 19% operating margins, vs. Southwest Co.'s 12%. And its stock? Shares have 156%, to $46, since the company's initial offering in April, 2002.

Small companies often use tech to offs economies of scale of bigger rivals. Gentex is the pacesetter in car mirrors. It has ac 40% gross margins by cutting costs 4% annually through IT. Gentex keeps adding automation and monitoring systems in its ries that pinpoint problems before too faulty products are made. That has upped ufacturing yield 30% in the past three Gentex's revenue is expected to jump 19 $472 million this year, says analyst Alexan Paris of Barrington Research Associates

Investors looking for promising stocks learn a lesson from these companies: A term commitment to technology can mea up on the competition.

Contributing: Wendy Zellner in Dalla

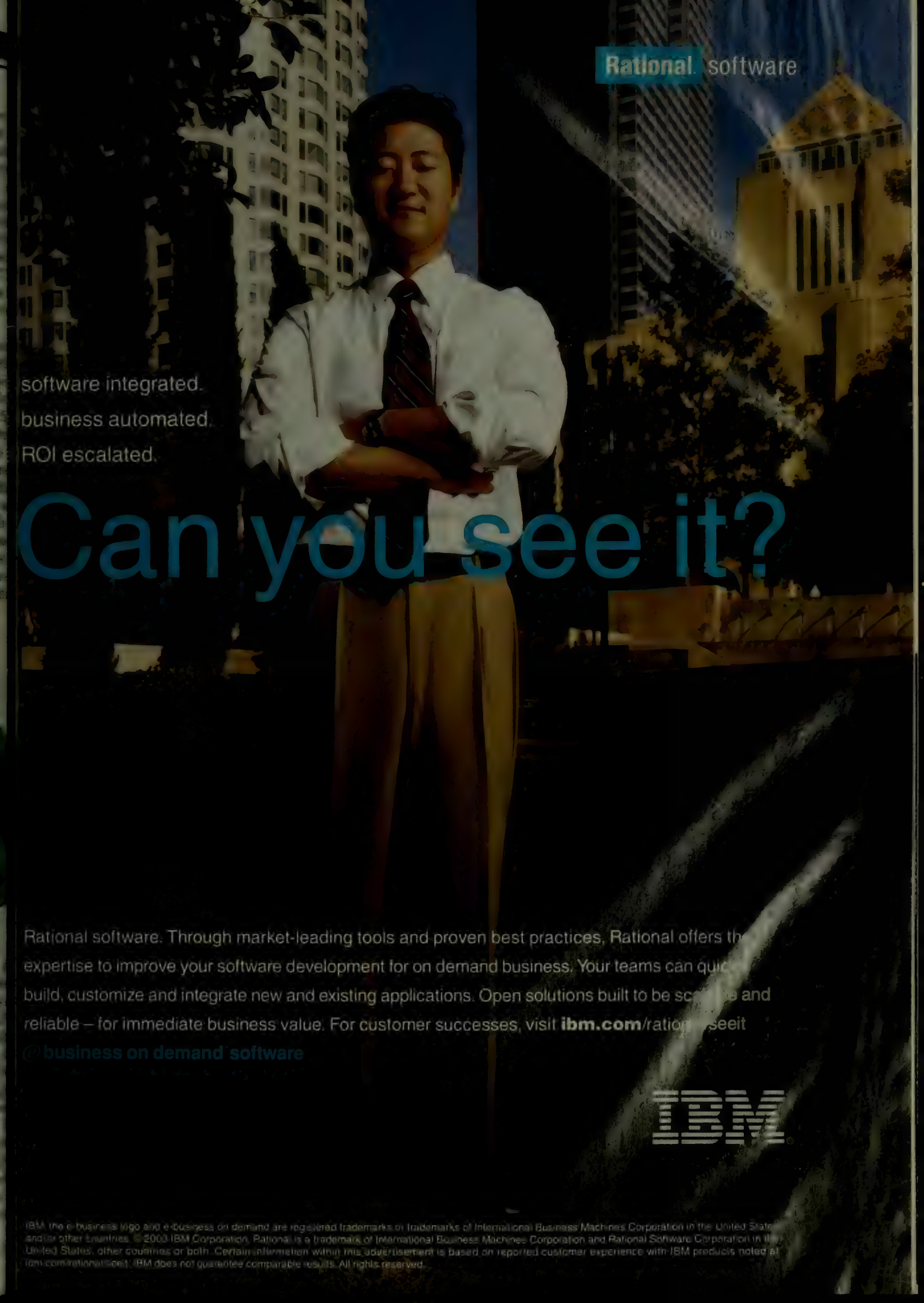
AMONG THE HIGH-TECH ACES

JETBLUE
Way ahead in using tech for everything from reservations to the cockpit: Pilots' laptops have updated flight manuals.

YELLOW
This trucker's 325 techies churn out fleet and employee scheduling systems that reduce costs and lower staffing.

PROGRESSIVE
The car insurer pioneered selling online and using wireless to handle claims from accident sites.

GENTEX
The auto-equipment maker uses tech to cut costs 4% to 5% annually, combating pricing pressure.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FROM THE DATA CENTER TO THE BOARDROOM:

STORAGE MOVES INTO THE SPOTLIGHT

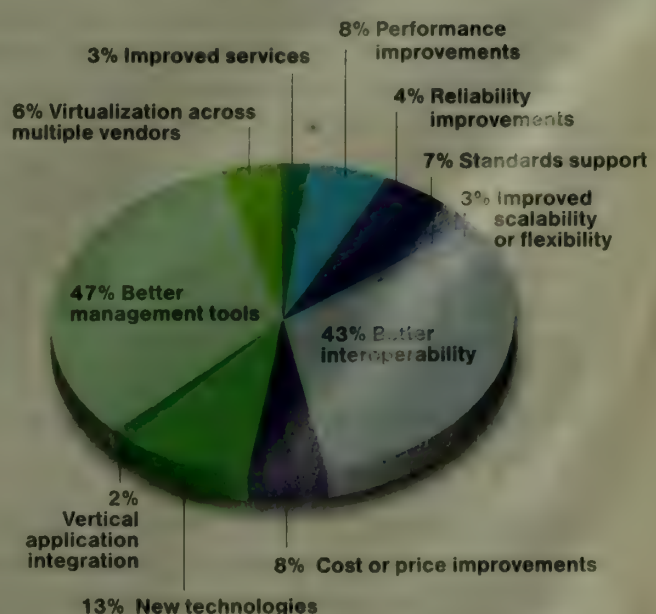
Storage used to be the province of technology gurus – a mysterious discipline where practitioners spoke of arcane issues such as RAID levels and the access density of magnetic tape. These days, the huge volumes of data that storage technologies protect are more valuable than almost any other corporate asset. Because of Internet and computer security disasters, new federal regulations, and the demand for transparency in corporate governance, ensuring the safety and availability of this data is paramount. As a result, a company's overall storage strategy – which includes the cost, availability, and manageability of storage – has become a critical concern for corporate executives as well as information technology professionals.

Business people are finally starting to understand that storage is crucial to their success," says Randy Kerns, partner at Evaluator Group Inc., Greenwood, Colo., which tracks the storage market. "The majority of the average corporate computer hardware budget is spent on storage, and the demand for storage capacity is growing exponentially. When a problem occurs within the storage system, it's an extremely visible failure. For companies struggling to prosper in this economy, properly managing storage strategies is too big an opportunity to ignore."

For the last decade, most organizations employed just one storage strategy: When storage capacity runs low, buy more. Industry experts such as Kerns estimate that storage grows from 60% to 100% annually at most companies. User communities continue to need ever-greater volumes to store data related to activities and transactions that are increasingly executed online. Ever since storage moved from costly mainframes to more affordable distributed media, storage costs have been relatively cheap. But over time, the "just buy more" philosophy created a management nightmare.

As departmental storage assets spread throughout organizations, so did the associated problems: out-of-date and duplicate data, allocated but unclaimed "orphaned" storage, and backup and recovery catastrophes. These manageability problems were serious in the late 1990s when IT budgets were growing 10% to 15% a year. When the economy tanked, shrinking IT staffs coupled with increasing storage demands complicated matters – leading to costly errors, staff burnout, and progressively worse manageability messes. "The main pain point for companies today is this economy," agrees Hu Yoshida, chief technology officer for storage vendor Hitachi Data Systems Corp., in Santa Clara, Calif. "This dip is longer, deeper, and wider than anyone would have expected three or four years ago. It has made companies very receptive to the economies associated with storage strategies such as consolidation."

Companies surveyed by the Storage Networking Industry Association showed a clear preference for improved storage network interoperability and manageability.



Source: SNIA, 2003

FROM THE DATA CENTER TO THE BOARDROOM:

STORAGE MOVES INTO THE SPOTLIGHT

Indeed, the pressure to manage a company's storage strategies is intense. Users expect to have the data they need, at precisely the moment they want it – not three days later, after IT has retrieved it from a tape archive. Federal requirements such as those set out by HIPAA and Sarbanes-Oxley demand that businesses retain huge volumes of data for increasingly lengthy time frames. Further, the impact of the losses experienced by many highly publicized disasters – from 9/11 to Internet worms and viruses – is still being tallied. Large enterprises aren't the only ones struggling with these issues – vendors report that sales of sophisticated storage solutions are skyrocketing for small and midsize businesses as well.

these images is difficult for resource-constrained IT st Single-image file systems combine the information into centralized view, which helps administrators more effici monitor distributed storage resources for bottlenecks even failures. "We're in the early stages of this technolo says analyst Kerns, "but it's one worth watching."

Another developing technology is Internet Small Comp System Interface, better known as iSCSI. Because it u the Internet Protocol (IP) to link data facilities, iS promises to facilitate data transfer over existing Ether based local-area and wide-area networks. For compa without the budget to invest in costly Fibre Channel netwo

The manageability challenge is extreme: Companies spend up t $7 per year to manage every dollar of storage.

All these demands require additional storage capacity and, perhaps more importantly, the personnel to manage it. Yet tight corporate budgets are forcing technology managers to slow their spending and maximize existing storage assets. As a result, businesses that value their data assets are looking for new answers – storage strategies that can help them strike the right balance between storage costs, availability, and manageability.

THE SHAPE OF THE FUTURE

The near-doctrinal NAS versus SAN debate has finally quieted, now that most of the industry recognizes that each has merits depending on a company's needs. Network-attached storage (NAS), in which storage media is attached to individual servers, is still popular for many organizations, especially small and midsize companies that relish the relatively low purchase price and simple manageability. In contrast, storage area networks (SANs) use high-performance Fibre Channel connections to pass huge volumes of storage from centralized reserves to users throughout large enterprises, where guaranteed reliability and availability levels are critical. Networked storage now accounts for a majority of storage revenues, with SAN spending projected to continue rising, according to Framingham (Mass.) market researcher IDC.

There are interesting developments in both markets. For NAS, new single-image file systems are helping organizations address their manageability problems. In traditional NAS environments, each storage device displays a unique image of its resources. Monitoring hundreds or thousands of

iSCSI sounds like a dream come true. "iSCSI has b slow to take off," acknowledges Bob Williamsen, dire of advanced development for storage networking ve McDATA Corp., in Broomfield, Colo. "But it will abso ly have play in terms of bringing new low-cost servers the storage network at a good price point."

GRAPPLING WITH THE MONSTER

The latest developments in SAN technology ar designed to enhance the manageability of these works. The challenge is extreme: One common estim is that companies spend up to $7 per year to ma every dollar of storage. In fact, management is one of fastest-growing components of the storage ma Market researcher Gartner Inc., in Stamford, Conn., jects that the storage management market will grow fr $4.9 billion in 2001 to $15.2 billion in 2006.

"With storage volumes growing geometrically, po solutions implemented to solve discrete problems, multivendor environments gaining in popularity, compa using SANs face monster integration and manage tasks," says Roger Reich, senior technical director of technology group at storage vendor VERITAS Softw Corp., Mountain View, Calif. "The solution is an overarch management tool that offers maximum control, secur and reliability."

One way to create that control is through policy-bas management features, which allow network administra to establish rules for operation of the SAN. Manage

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STORAGE MOVES INTO THE SPOTLIGHT

tools help companies determine backup schedules, provide snapshots of storage volumes that allow operators to identify problems and errors, manage the availability of specific blocks of storage, and specify – at the user and application level – who gets how much storage capacity.

The most sophisticated manageability tools provide templates or profiles that allow administrators to design user roles or application classes. Individual users or programs are then assigned to a particular template, saving administrators the time of specifying unique storage rights for every user or application and enhancing management efficiency. In addition, these newer manageability tools display information graphically, which means that an organization's storage resources are easily viewable and routine changes can be handled by operators rather than already overburdened storage experts.

UNCOVERING OPPORTUNITIES

At UAL Loyalty Services Inc., a Chicago-based subsidiary of UAL Corp. that manages United Airlines' customer loyalty programs, a new storage management system restored quality of life to senior systems and storage architect Gary Pilafas. With 25 terabytes of storage to manage, provisioning – where storage capacity is apportioned and re-apportioned among users and applications – was by far the biggest job. Only two of the company's 10 storage administrators were expert enough to make changes to the SAN, meaning that Pilafas rarely had time for his architect duties.

UAL Loyalty Services implemented the Storage Operations Management suite from vendor CreekPath Systems, Longmont, Colo. The solution "discovered" the company's entire storage production environment within two and a half hours. Nine IT staff members were quickly trained to use the solution, and the company achieved its projected return on investment within 45 days.

Perhaps more important, freeing up the senior engineers allowed the company to pursue other valuable IT projects that had been shelved because there was no time for them. "CreekPath gave us the ability to change the storage environment through a single pane of glass, with having to be experts on every appliance on the SA says Pilafas. "I got my job back, which means my dir tor of operations now has his architect back in servic

SIMPLICITY THROUGH ABSTRACTIO

Another hot feature in the storage management marke virtualization. Introduced nearly four years ago, virt ization uses logical representations of physical resour to simplify complex management tasks. The technol abstracts the details of multivendor, heterogene storage environments into a centralized, unified pict of the storage environment. Storage experts can use t abstracted representation to manage storage ass optimize capacity utilization, and choose storage pa and devices on a per-application basis to enha performance. Virtualization is only now beginning to critical mass, but industry watchers expect all the m vendors to offer the technology by yearend.

The simplicity that can be derived from abstraction ca bilities is not limited to storage management. In an eff to bring simplicity to networked storage environments, b

> "Having a central management vision is just as important as the technology." – Bob Venable, manager of enterprise systems, BlueCross BlueShield of Tennessee

vendor is approaching storage with a virtualization applian that handles both NAS and SAN protocols within the stora fabric, with minimal management by storage administrato "What used to be an almost religious battle between NAS a SANs is no longer relevant today," explains Mark Santor senior vice president of worldwide marketing for vend Network Appliance Inc., Sunnyvale, Calif. "Enterprises a less interested in technology, and more interested in t ROI it can deliver."

Network Appliance recently introduced a new approa fabric-attached storage, which transparently handles bo block and file access in an enterprise storage infr structure. With this appliance approach, compani can use either NAS or SAN technology. For example, a Network Appliance customer striving for consistency af a merger used the technology to switch quickly from NA to SAN without recreating its data or access mechanism "This technology allows businesses to use the most co effective technology for their needs, without worryi about storage protocols," Santora says.

NAS or SAN?

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STORAGE MOVES INTO THE SPOTLIGHT

With the expanding volume of storage, few companies rely on just one vendor to handle all their storage needs. "The days of any one vendor having 70% of the market share are gone," says Yoshida of HDS. "Most customers want at least a two-vendor solution." But using multiple vendors requires a standards-based storage strategy, one that enables products to exchange information despite differences in architecture or programming.

HOLDING STORAGE TO A STANDARD

Earlier this year, the Storage Networking Industry Association (SNIA), a consortium of more than 300 storage companies and individuals headquartered in San Francisco, introduced Version 1 of the Storage Management Initiative Specification (SMI-S). SMI-S is an interoperable management interface for multivendor storage networking products. It provides the industry's first common management backbone for storage networks. Roger Reich, who is a member of the SNIA board of directors as well as chairman of the SMI committee, says that the specification includes all major vendors. SNIA's goal is for all new storage networking products to use the standard in 2005.

Yet experienced users say that technology is not the only consideration in creating a successful storage strategy. Bob Venable, manager of enterprise systems for BlueCross BlueShield (BC/BS) of Tennessee, in Chattanooga, warns that solid management is equally important: "Long-term, having a central management vision is just as important as the technology." With 200 servers, 70 storage devices, and four application environments, the company needed a well-planned strategy that would help it remain competitive into the future.

Venable's organization first identified its real goal: to be able to share data with everyone, eventually including its customers. From that point, he says, it was clear that the organization needed a single cross-enterprise SAN – one that could support hot code activation and back out in case of problems, and one that could support a director-class workload. BC/BS choose a SAN solution from McDATA. With a clear management vision and the appropriate tool, the organization's payback was dramatic: a 40% increase in storage utilization, a 60% decrease in storage acquisition costs, a 70% decrease in storage maintenance costs, and a 95% reduction in downtime costs. The first-year ROI was estimated at just under $600,000, with a three-year ROI of 322%. "I'm passionate about this," Venable says. "So much of our success came from our cohesive management direction."

STRATEGIES FOR SUCCESS

Creating a cohesive strategy throughout the enterpri surely the best way to organize for storage success. M experienced companies are even soliciting input into storage choices from non-IT managers. These mana are asked to participate in the creation of tiered se levels, where a selected level of performance, availability, recoverability is assigned to specific applications or data. higher the chosen level, the higher the pricetag for the a ciated storage. "Discussing which tier of service a reso requires is a great way to engage the entire business dialogue that helps determine the company's real sto priorities," says Chuck Hollis, vice president of sto platforms marketing for vendor EMC Corp., Hopkinton, M

More products and services to help companies enh their storage strategies and optimize storage assets a the pipeline. In 2004, for example, look for vendo begin delivering technologies that automate the agement of information through its entire lifecycle, creation to retirement. When these information lifec management tools hit their stride, storage administr will be freed to handle more complex storage manage issues, further optimizing companies' storage asset

Despite storage's past reputation as a stodgy, unintere technology, today's storage strategies are providing s of the most anticipated and unprecedented new b ness opportunities. Says Dennis Grant, CEO of Creek Systems: "Seeing customers recognize that they can storage as a way to drive cost out of their organizations build new efficiencies is fantastic. It's an exciting tim be choosing and refining corporate storage strategi

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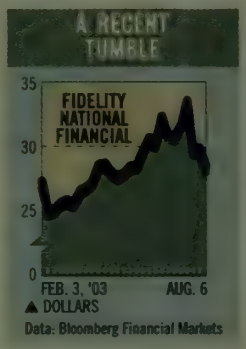
BY GENE G. MARCIAL

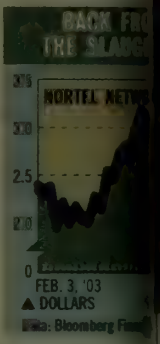
More Faith in Fidelity

As the Street worries more about hikes in interest rates, investors are fleeing rate-sensitive stocks. One such: Fidelity National Financial (FNF), No. 1 in U.S. title insurance, which tumbled from 34.86 a share on July 14 to 28 on Aug. 6. The stock could face more pressure, but some pros see this as a chance to buy: "When jitters over rates clear, Fidelity will leap to 60 in 12 months," says Don Gimbel of Carrett & Co., which has been buying. "The boom in title insurance will continue as rising rates are offset by other secular factors that buoy new mortgages," says Audrey Snell of research outfit Brean Murray, who rates Fidelity a strong buy. In April, Fidelity started providing software and other services to mortgage outfits—following its March purchase of an Alltel unit that provides such wares. Software should account for 50% of revenues, or $3.5 billion of an estimated total of $7 billion, by 2005, figures Gimbel. Title policies now account for 50%, and real-estate related services the rest. Snell raised her 2003 earnings estimate to $5.88 a share after Fidelity posted robust second-quarter results, which included software. For 2004, she expects lower earnings—$4.25, on "curtailed" refi volume. But in 2005, she sees software-related revenues rising. Most software stocks trade at a 20 to 25 price-earnings ratio, while insurers sell in the single digits, notes Snell. Fidelity's p-e is 6.5, based on 2004 estimates. Gimbel sees 2005 earnings of $5 and says Fidelity deserves a 12 p-e, or 60 a share. Fidelity was featured in this column on May 6, 2002, when it was at 21.



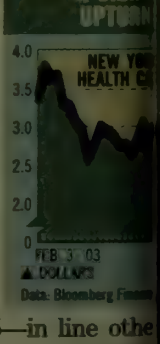
Will a Buyer Dial Nortel's Number?

One of the dogs that got skinned in the telecom slaughter was Nortel Networks (NT), plunging from 86 a share (after three splits) in 2000 to 40¢ by 2002. It has since rallied to 2.84. Suddenly, Nortel looks alluring—to some. After worrying that Nortel might go belly-up, certain analysts now expect the network-gear supplier to be in the black by 2004. And with a cash stash of $4 billion—enough to cover its debt—Nortel "is looking like an attractive takeover bet," says Carl Birkelbach, CEO of Birkelbach Investment Securities, who has been buying. "My technical indicators say Nortel is a long-term bu huge potential in the next three years," says Birkelba has been writing *Investment Strategy Letter* since 1978. Nortel could be worth twice its current price in a takeover, he says. Rumor says a foreign telecom and a buyout group are interested. Some bottom-fishers have been buying into telecoms, including Carl Icahn, who took control of XO Communications and is also after Global Crossing. Warns Birkelbach: Nortel is "risky" and "speculative." It has slashed its workforce from 55,000 to 37,000. Overcapacity in telecom continues to plague Nortel, says Stuart Plesser of Value L expects it to break even in 2003 on $9.5 billion sales a 5¢ a share in 2004 on $9.8 billion. Nortel didn't return



Good Test Results at New York Health Care

A little-known company with no Wall Street ing, New York Health Care (BBAL) share been active: They jumped from 2 in early 3.28 on Aug. 6. The reason: The compan Balance unit has a proprietary product, I trix—an oral liquid formulation—that was effective in AIDS-related diarrhea in a clinical study. As a result Operating Officer Dennis O'Donnell says the compa explore a prescription drug for AIDS-related diarrhe developing treatments for other gastrointestinal disorders, including Crohn's disease. Orton Chen of RedChip Research notes that Probactrix is approved as an over-the-counter drug in Russia and as a food supplement in Israel. He says Probactrix will benefit from the recent focus on irritable bowel syndrome and antibiotic-associated diarrhea, which afflicts AIDS patients. O'Donnell notes that diarrhea will affect most of the 1 million Americans living with HIV. Chen says the stock deserves a p-e ratio of 35—in line othe itable biotechs. His target price: 8, based on his foreca New York Health Care will earn 12¢ in 2004 and 36¢ i



BusinessWeek online Gene Marcial's Inside Wall Street is at businessweek.com/today.htm at 5 the magazine's publication day, usually Thursdays. See Gene on Fri 1:40 p.m. EST on CNNfn's *The Money Gang*.

Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships

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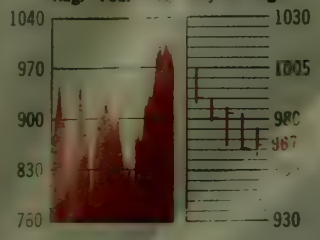
BusinessWeek Investor FIGURES OF THE WEEK

STOCKS

S&P 500

Aug. Feb. July 31-Aug. 6



COMMENTARY

The markets declined despite an Aug. 4 report showing that June factory orders rose a better-than-expected 1.7% and news that service industries expanded sharply. Still, worries about the recovery and the falling bond market keep nagging at investors. Disappointing quarterly sales at Cisco hurt the stock—along with the NASDAQ—on Aug. 6.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	AUG. 6	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	967.1	–2.1	9.9	12.5
Dow Jones Industrials	9061.7	–1.5	8.6	9.5
NASDAQ Composite	1652.7	–4.0	23.7	31.2
S&P MidCap 400	481.1	–3.0	11.9	14.3
S&P SmallCap 600	223.8	–3.4	13.8	16.5
Wilshire 5000	9307.5	–2.3	11.6	14.2
SECTORS				
BusinessWeek 50*	566.3	–2.2	4.4	7.0
BW Info Tech 100**	304.7	–1.8	6.8	15.2
S&P/BARRA Growth	489.2	–2.2	9.0	10.6
S&P/BARRA Value	474.5	–1.9	10.9	14.6
S&P Energy	189.8	0.7	3.6	8.8
S&P Financials	336.1	–2.4	13.2	15.1
S&P REIT	103.3	–1.8	13.7	11.2
S&P Transportation	174.8	–0.9	2.8	4.3
S&P Utilities	103.5	–1.1	5.9	0.3
GSTI Internet	118.3	–9.0	58.3	94.5
PSE Technology	572.8	–2.4	25.0	34.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	AUG. 6	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	547.3	–1.3	17
London (FT-SE 100)	4070.4	–1.7	
Paris (CAC 40)	3126.2	–1.5	2
Frankfurt (DAX)	3375.7	–1.6	16
Tokyo (NIKKEI 225)	9323.9	–3.2	6
Hong Kong (Hang Seng)	8987.5	–1.3	7
Toronto (S&P/TSX Composite)	7139.1	–1.2	7
Mexico City (IPC)	7230.1	–0.4	18

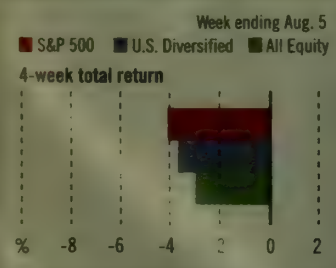
FUNDAMENTALS	AUG. 5	WK. AGO
S&P 500 Dividend Yield	1.70%	1.65%
S&P 500 P/E Ratio (Trailing 12 mos.)	27.5	29.1
S&P 500 P/E Ratio (Next 12 mos.)*	16.5	17.0
First Call Earnings Revision*	0.24%	0.36%

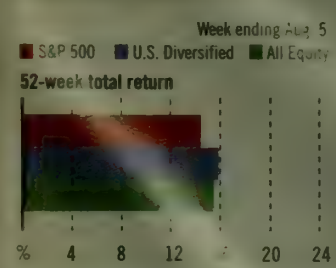
TECHNICAL INDICATORS	AUG. 5	WK. AGO
S&P 500 200-day average	911.7	908.7
Stocks above 200-day average	72.0%	79.0%
Options: Put/call ratio	0.78	0.71
Insiders: Vickers NYSE Sell/buy ratio	4.24	4.15

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Motorcycles	16.5	Internet Software	155.6
Department Stores	15.3	Wireless Services	120.3
Constr. & Farm Machinery	13.4	Internet Retailers	83.8
Gold Mining	11.9	Office Electronics	63.8
Semiconductor Equip.	10.5	Comptr. Stge. & Perphs.	57.2

WORST-PERFORMING GROUPS	LAST MONTH %	
Internet Software	–15.5	Tires & Rubber
Multi-Utilities	–14.7	Health-Care Facilities
Health-Care Services	–13.9	Food Chains
Tobacco	–12.5	Tobacco
Distributors	–8.7	Automobiles

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	6.1	Communications	39.1
Pacific/Asia ex-Japan	2.4	Precious Metals	36.7
Europe	1.1	Technology	35.0
Real Estate	–0.3	Latin America	26.4
LAGGARDS		**LAGGARDS**	
Communications	–6.1	Japan	–2.8
Utilities	–6.1	Diversified Pacific/Asia	5.9
Japan	–5.7	Miscellaneous	9.4
Technology	–5.1	Utilities	9.7

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
American Heritage	28.6	Jacob Internet	132.1
Scudder Gold & Pr. Mts. S	12.4	Amerindo Technology D	105.0
Rydex Dynam. Vent. 100	10.6	Fidelity Adv. Lvgd. Co. A	100.3
PFds. UltSh. OTC Inv.	10.3	Apex Mid Cap Growth	98.7
LAGGARDS		**LAGGARDS**	
Frontier Equity	–25.6	Frontier Equity	–67.4
Grand Prix A	–13.1	Rydex Dynam. Vent. 100	–62.0
PFunds. Ultra Japan Inv.	–12.9	PFds. UltSh. OTC Inv.	–62.0
Black Oak Emerg. Tech	–12.4	Potomac OTC/Short Inv	–36.3

INTEREST RATES

KEY RATES	AUG. 6	WEEK AGO
MONEY MARKET FUNDS	0.58%	0.64%
90-DAY TREASURY BILLS	0.94	0.95
2-YEAR TREASURY NOTES	1.77	1.62
10-YEAR TREASURY NOTES	4.27	4.31
30-YEAR TREASURY BONDS	5.24	5.25
30-YEAR FIXED MORTGAGE†	6.35	6.23

†BanxQ

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND
GENERAL OBLIGATIONS	4.10%
TAXABLE EQUIVALENT	5.86
INSURED REVENUE BONDS	4.18
TAXABLE EQUIVALENT	5.97

THE WEEK AHEAD

FOMC MEETING *Tuesday, Aug. 12, 9 a.m. EDT* ▶ The Federal Reserve Board's Open Market Committee meets to set monetary policy. Across the board, economists surveyed by MMS International believe the Fed will keep its federal funds rate at 1%.

RETAIL SALES *Wednesday, Aug. 13, 8:30 a.m. EDT* ▶ July retail sales probably grew by 0.5% for a second consecutive month. Excluding vehicles, sales most likely rose by 0.4%, after surging 0.7% in June.

PRODUCER PRICE INDEX *Thursday, Aug. 14, 8:30 a.m. EDT* ▶ Producer prices probably rose by 0.2% in July, after a 0.5% jump in June. Excluding food and energy, prices very likely ticked up 0.1%, reversing a 0.1% drop the month before.

CONSUMER PRICE INDEX *Friday, Aug. 15, 8:30 a.m. EDT* ▶ July consumer prices for goods and services are expected to have climbed 0.2% for a second straight period. Minus food and energy, prices moved 0.1% higher, after holding steady.

INDUSTRIAL PRODUCTION *Friday, Aug. 15, 9:15 a.m. EDT* ▶ Factory output in July probably expanded by 0.2%, following a 0.1% increase during June. The average operating rate is forecast to have improved to 74.4%, from 74.3%.

The *BusinessWeek* production index [illegible] 200.5 in the week ended July 26, up 3.1% a year ago. Before calculation of the four-week moving average, the index slipped to 20[illegible]

BusinessWeek online

For the BW50, more investment data, and components of the production index visit www.businessweek.com/magazine/ext[illegible]

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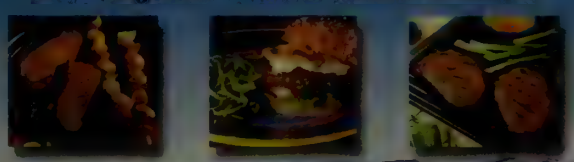

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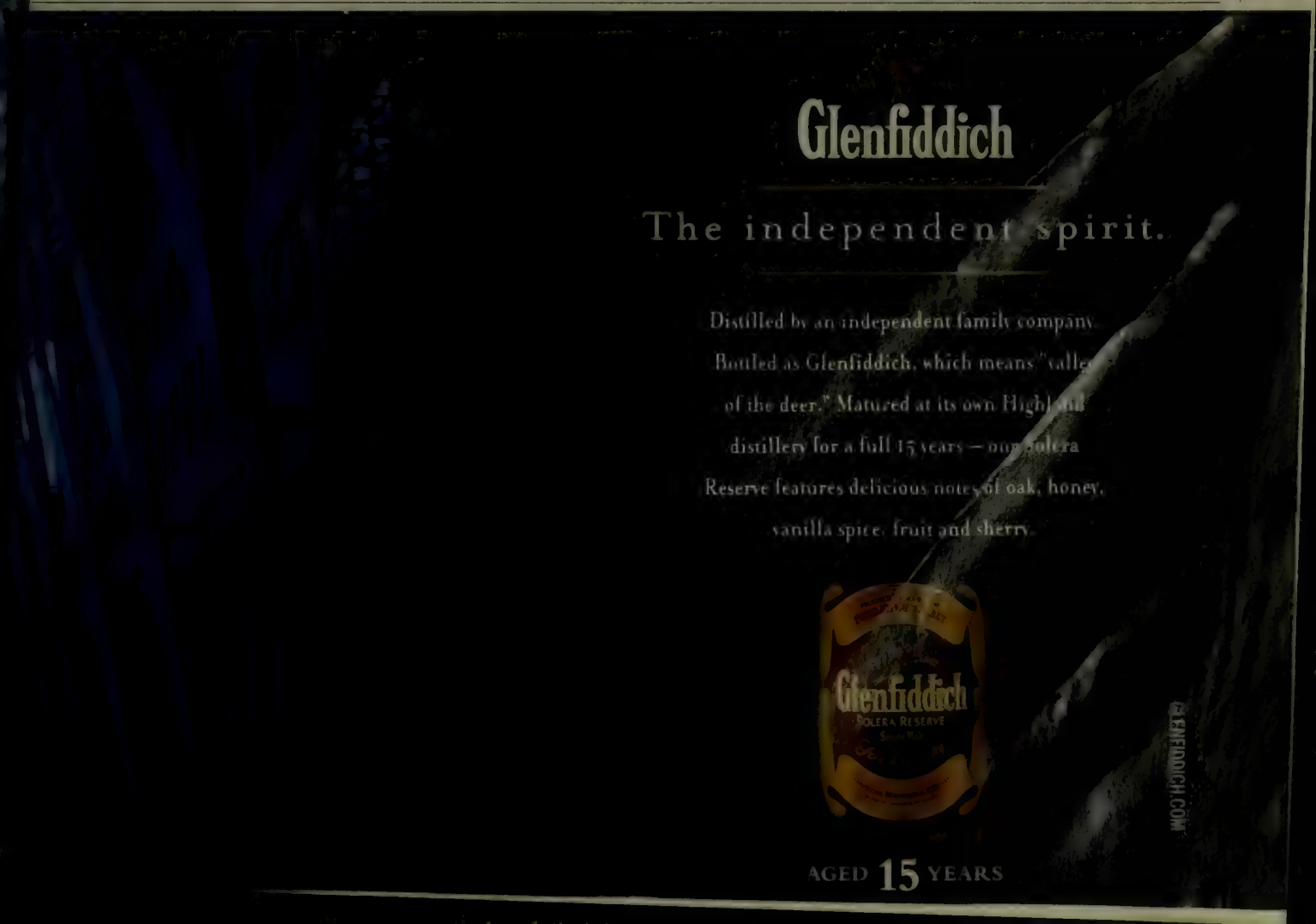

TECHNOLOGY: HERE COMES THE NEXT WAVE

The boom. The bust. Now what? Burned by exaggerated promises in the '90s and angry at betting their 401(k)s on the hype, many folks are tempted to believe that the information-technology revolution is overrated, overdone, and just plain over. So great is the backlash that the *Harvard Business Review* recently ran an article entitled "IT Doesn't Matter." Don't believe it for a nanosecond. The new ways we do mundane things—tour colleges electronically, board airlines with e-tickets, and communicate digitally with family and friends—are now second nature, integral to our lives. While we may take technology for granted, the reality is that the value of technology is greater than ever (page 64).

The right attitude toward tech is neither dark pessimism nor wild optimism, but sober realism. After the '90s binge on glitchy hardware and buggy software, CEOs are justified in demanding that new technology be simple, easy to use, and produce results that add to the bottom line. Purveyors of high-tech products would do well to realize that the market has seriously changed: They must deliver the goods, not just the promise of the goods.

CEOs, for their part, must realize that tech's power to transform their businesses hasn't waned. In fact, the bursting of the high-tech bubble solidified tech's position in Corporate America. The need to cut costs led companies to fully use their existing technology. The Web became the backbone of every big corporation. Companies survived by using productivity-enhancing IT to trim jobs and outsource production. Productivity growth's unusual gains throughout the downturn reflect tech's impact. Yet many CEOs are content to live off past high-tech investments and are reluctant to try new technologies for the future.

Not so consumers. They're changing the patterns of their lives by buying digital cameras, smart cell phones, MP3 and DVD players, and personal video recorders such as TiVo. They're making dates on Match.com, downloading music from the Net, instant messaging, sending photos on their PCs, and building a grassroots model of economic exchange [illegible] (page 124). In the process, they're promoting new info technologies, such as Wi-Fi and file-sharing, and sha the telecom, music, and movie industries. Consumer lost faith in technology.

It's time Corporate America rekindles its own fait some fun along with it. Look at what Prada is doing dio-frequency identification chips. As customers pass its shops with their clothes, RFIDs on the tags trigge screens showing runway models in Milan wearing th shoes and dresses. In dressing rooms the RFID tags videos of the clothes combined with different outfits. the scenes, the RFIDs control inventory. Think of wh Mart Stores Inc. could do with RFIDs.

Witness what Apple Computer Inc. is achieving w iPod player and iTunes Web site, and imagine what tainment could be like if music and movie compani braced digital distribution instead of fighting it. I think of broadband without cables, linked by Wi-Fi frequencies carrying those movies and songs—along data, conversations, and home videos. All of these nologies already exist, waiting for companies willing vest in them.

There are, of course, problems ahead. Spam, identity and privacy issues may slow the spread of e-commerce Internet (page 114). Investor memories of being misl Wall Street haven't disappeared, despite the runup i prices of high-tech stocks. This could hamper the financ another round of startups. But the idea that inform technology is dead—that it's no longer a major driv economic growth and that the future holds few surprise just not true. Says Andrew S. Grove, chairman of Intel and a forty-year tech veteran: "There are huge, huge t going on, and we are too myopic to notice. We can't glimpse the many ways IT will change how people work live." Amen.

HOW TO SHARPEN AMERICA'S EDGE

A backlash is beginning against the migration of high-paying white-collar jobs in software, engineering, design, and accounting to India, China, the Philippines, and other lower-cost countries. It's one thing for workers in older industries such as steel and textiles to lose out to the comparative advantages of overseas competition. But college-educated employees in high-tech industries? That's different. Right?

Well, actually, no. Dynamic, competitive economies such as America's are always evolving—with workers with the most advanced skills creating higher-value products and services getting the biggest rewards. The knowledge-sector of the U.S. economy is simply going through the same evolutionary process as manufacturing did in the '80s. Lower-level kn edge jobs are being commoditized. From a company's spective, they're cheaper and easier to do by educated pe overseas. Hence, they are moving (page 37).

The answer isn't to curb immigration or cut off visas bu improve America's own schools and universities. China India have built world-class education systems. The U.S. r do better than ever, particularly in the sciences. It must continue to be open to the best and brightest of the world, spite security worries. America's future rests on what it c best—innovation. Washington should keep that in mind ponders what to do about the loss of white-collar jobs.